

SMITH & NEPHEW PLC
Form 20-F
April 25, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

or

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2002

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 0-19003

Smith & Nephew plc

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organization)

15 Adam Street, London WC2N 6LA

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name on each exchange on which registered
American Depositary Shares Ordinary Shares of 12 ² /9p each	New York Stock Exchange New York Stock Exchange*

* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None.

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None.

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

928,759,544	Ordinary Shares of 12²/9p each
268,500	Cumulative Preference Shares of £1 each

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

Indicate by check mark which financial statement item the registrant has elected to follow: Item 17 Item 18

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INTRODUCTION

As used in this Annual Report, the term "Company" refers to Smith & Nephew plc or, where appropriate, the Company's Board of Directors, unless the context otherwise requires. The terms "Smith & Nephew" and "Group" are used for convenience to refer to the Company and its consolidated subsidiaries, unless the context otherwise requires.

The Consolidated Financial Statements of the Company in this Annual Report are presented in United Kingdom ("UK") pounds sterling. In this document, references to "US dollars" or "US\$" or "cents" are to United States ("US") currency, references to "euros" or "€" are to the currency used in member states of the European Union, references to "Swiss francs" or "CHF" are to the currency used in Switzerland and references to "pounds sterling", "sterling" or "£", "pence" or "p" are to UK currency. 1p is equivalent to one hundredth of £1.

Solely for the convenience of the reader, certain parts of this Annual Report contain translations of amounts in sterling into US dollars at specified rates. These translations should not be construed as representations that the sterling amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated. The translation of pounds sterling and pence to US dollars and cents appearing in this Annual Report have been made at the noon buying rate in The City of New York for cable transfers in sterling as certified for customs purposes by the Federal Reserve Bank of New York (the "Noon Buying Rate") on the date of the information so translated. On April 7, 2003, the Noon Buying Rate was US\$ 1.550 per £1.

A substantial portion of the Group's assets, liabilities, revenues and expenses is denominated in currencies other than sterling. Accordingly, fluctuations in the value of sterling relative to other currencies can have a significant effect on the translation into sterling of non-sterling assets, liabilities, revenues and expenses. For information regarding rates of exchange between sterling and US dollars and the effects of changes in exchange rates, see Item 3 "Key Information Exchange Rates" and Item 11 "Quantitative and Qualitative Disclosures About Market Risk".

On November 16, 1999, the Ordinary Shares of the Company were listed on the New York Stock Exchange, trading in the form of American Depositary Shares ("ADSs") evidenced by American Depositary Receipts ("ADRs"). Each ADS represents ten Ordinary Shares.

The Company furnishes the Bank of New York, as Depositary, with annual reports containing Consolidated Financial Statements and an opinion thereon by its independent auditors. Such financial statements are prepared on the basis of accounting principles generally accepted in the United Kingdom ("UK GAAP"). The annual reports contain reconciliations of net income, cash flow and shareholders' equity stated under UK GAAP to those as stated under accounting principles generally accepted in the United States ("US GAAP"). The Company also furnishes the Depositary with semi-annual reports prepared in conformity with UK GAAP, which contain unaudited interim consolidated financial information. Upon receipt thereof, the Depositary mails all such reports to recorded holders. The Company also furnishes to the Depositary all notices of shareholders' meetings and other reports and communications that are made generally available to shareholders of the Company. The Depositary makes such notices, reports and communications available for inspection by recorded holders of ADRs and mails to all recorded holders of ADRs notices of shareholders' meetings received by the Depositary. The Company is not required to report quarterly financial information.

The Company's fiscal year ends on December 31 of each year. References in this Annual Report to a particular year are to the fiscal year unless otherwise indicated. Except as the context otherwise requires, "Ordinary Share" or "share" refer to the ordinary shares of Smith & Nephew² of 12 each. References in this Annual Report to the "Companies Act" are to the Companies Act 1985, as amended, of Great Britain. References to the "FDA" are to the US Food and Drug Administration.

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This Annual Report contains the Consolidated Financial Statements and Financial Statement Schedules of Smith & Nephew and an opinion thereon by its independent auditors. Such financial statements are prepared under accounting principles generally accepted in the United Kingdom (UK GAAP). UK GAAP differ in certain respects from US generally accepted accounting principles (US GAAP). Differences between UK GAAP and US GAAP relevant to the Group are explained in Note 35 of the Notes to the Financial Statements.

Special Note Regarding Forward-Looking Statements

Certain statements contained in this Annual Report under the headings Item 4 Information on the Company, Item 5 Operating and Financial Review and Prospects, Item 8 Financial Information and Item 11 Quantitative and Qualitative Disclosures About Market Risk and elsewhere constitute forward-looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995. When used in this Annual Report, the words anticipate, believe, estimate, expect, consider and similar expressions are generally intended to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of Smith & Nephew, or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Specific risks faced by the Company are described under Item 3 Key Information Risk Factors.

Smith & Nephew expressly disclaims any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement contained herein to reflect any change in Smith & Nephew's expectation with regard thereto or any change in events, conditions or circumstances on which any such statement is based. All subsequent written and oral forward-looking statements attributable to Smith & Nephew or persons acting on behalf of Smith & Nephew are expressly qualified in their entirety by the foregoing.

Certain Specialist Terms

Unless the context indicates otherwise, the following terms have the meanings shown below:

Advanced wound management products are those associated with the treatment of skin wounds, ranging from products that provide moist wound healing using breathable films and polymers to products providing active wound healing by biochemical or cellular action.

Arthroscopic repair products are specialized devices, fixation systems and bioabsorbable materials to repair damaged tissue.

Bandaging products comprise traditional adhesive and support bandaging, Casting products are used externally to immobilize a fracture or damaged joint structures, usually made of plaster of paris or synthetic materials and Traditional woundcare products are those which comprise medical textile products that include adhesive tapes and fixture sheets used to secure wound management products to the body.

Chronic and acute wounds. Chronic wounds are those with long or unknown healing times including leg ulcers, pressure sores and diabetic foot ulcers. Acute wounds are those for which healing times can be reasonably predicted such as surgical and post-operative wounds.

Endoscopy products are specialized viewing devices, instruments and powered equipment used in minimally invasive surgical procedures. Through a small incision, surgeons are able to see inside the body via a monitor and identify and repair defects. Endoscopy of the joints is termed arthroscopy, with the principal applications being the knee and shoulder.

Image guided surgery is the use of computer-tracking and imaging technological tools that give surgeons real-time, precise feedback on the relationship between surgical instruments and the patient's anatomy.

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Orthopaedic products comprise implants, devices and systems to replace diseased or injured hip, knee and shoulder joints, and trauma products, devices such as rods, pins, screws and plates used to treat bone fractures.

Resection products comprise radiofrequency wands, electromechanical and mechanical blades, and hand instruments for resecting tissue. Access products are fluid management and insufflation instruments for better surgical access.

Rehabilitation products are individual items, pieces of equipment or product systems that are used to increase, maintain or improve functional capabilities after surgery or of individuals with disabilities.

Visualization products are digital cameras, digital image capture, central control, multimedia broadcasting, scopes, light sources and monitors to assist with visualization.

Product names referred to in this Annual Report are identified by the use of capital letters and are trademarks owned by or licensed to members of the Group or its associated undertakings and other interests.

PART I

ITEM 1 IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable

ITEM 2 OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable

ITEM 3 KEY INFORMATION

SELECTED FINANCIAL DATA

Summary

This information has been extracted or derived from the audited financial statements of the Group presented elsewhere in this Annual Report and in prior year Annual Reports on Form 20-F.

Smith & Nephew prepares its financial statements in accordance with UK GAAP which differ in certain respects from US GAAP. Reconciliations of net income and shareholders' equity are set forth in Note 35 of the Notes to the Financial Statements.

Consolidated Income Statement Data

	Years ended December 31				
	2002	2001	2000	1999	1998
(£ million, except per Ordinary Share and per ADS amounts)					
Amounts in accordance with UK GAAP:					
Turnover:					
Continuing operations	1,083.7	978.3	911.5	799.9	713.6
Discontinued operations	26.2	103.4	223.2	320.0	339.8
	<u>1,109.9</u>	<u>1,081.7</u>	<u>1,134.7</u>	<u>1,119.9</u>	<u>1,053.4</u>
Group turnover	1,109.9	1,081.7	1,134.7	1,119.9	1,053.4
Share of joint venture	155.0	123.6			
	<u>1,264.9</u>	<u>1,205.3</u>	<u>1,134.7</u>	<u>1,119.9</u>	<u>1,053.4</u>
Operating profit:					
Continuing operations:					
Before goodwill amortization and exceptional items	196.0	174.4	156.9	122.7	106.5
Goodwill amortization *	(17.5)	(10.4)	(6.9)	(1.8)	(0.3)
Exceptional items *	(29.9)	(21.1)	(12.4)	(40.1)	(15.9)
Discontinued operations:					
Before exceptional items	2.1	11.1	29.0	46.6	47.9
Exceptional items *			(3.9)	(11.6)	(2.0)
	<u>150.7</u>	<u>154.0</u>	<u>162.7</u>	<u>115.8</u>	<u>136.2</u>
Share of operating profit of the joint venture:					
Before exceptional items	19.6	12.8			
Exceptional items *	(2.6)	(5.0)			
	<u>167.7</u>	<u>161.8</u>	<u>162.7</u>	<u>115.8</u>	<u>136.2</u>
Share of operating profit of the associated undertaking					
	4.9				
	<u>172.6</u>	<u>161.8</u>	<u>162.7</u>	<u>115.8</u>	<u>136.2</u>
Profit on disposal of businesses *					
	18.0	49.2	109.5	62.9	
	<u>190.6</u>	<u>211.0</u>	<u>272.2</u>	<u>178.7</u>	<u>136.2</u>
Profit before interest	190.6	211.0	272.2	178.7	136.2
Interest income	6.6	2.5	4.4	10.3	8.1
Interest expense	(19.3)	(19.9)	(11.4)	(6.9)	(9.8)
	<u>177.9</u>	<u>193.6</u>	<u>265.2</u>	<u>182.1</u>	<u>134.5</u>
Profit before taxation	177.9	193.6	265.2	182.1	134.5
Taxation	(65.8)	(64.0)	(57.7)	(77.3)	(40.8)
	<u>112.1</u>	<u>129.6</u>	<u>207.5</u>	<u>104.8</u>	<u>93.7</u>
Profit for the financial year					
	<u>112.1</u>	<u>129.6</u>	<u>207.5</u>	<u>104.8</u>	<u>93.7</u>
Per Ordinary Share:					
Basic earnings per Ordinary Share	12.11p	14.07p	20.07p	9.39p	8.42p
Diluted earnings per Ordinary Share(i)	12.02p	13.95p	19.95p	9.37p	8.40p
Results before goodwill amortization and exceptional items (marked * above):					
Profit before taxation	209.9	180.9	178.9	172.7	152.7
Adjusted basic earnings per Ordinary Share	16.02p	13.96p	12.19p	10.88p	9.61p

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Adjusted diluted earnings per Ordinary Share	15.89p	13.84p	12.12p	10.85p	9.60p
Ordinary Dividends per Ordinary Share	4.80p	4.65p	4.50p	6.50p	6.20p
Special Dividend per Ordinary Share			37.14p		
Amounts in accordance with US GAAP:					
Income from continuing operations	128.4	74.9	85.3	66.6	39.9
Income from discontinued operations		32.0	116.9	22.3	25.8
Net income	<u>128.4</u>	<u>106.9</u>	<u>202.2</u>	<u>88.9</u>	<u>65.7</u>
Basic earnings per Ordinary Share:					
Continuing operations	13.87p	8.13p	8.25p	5.97p	3.58p
Discontinued operations		3.47p	11.31p	2.00p	2.32p
Total	<u>13.87p</u>	<u>11.60p</u>	<u>19.56p</u>	<u>7.97p</u>	<u>5.90p</u>
Ordinary dividends per Ordinary Share	4.70p	4.55p	5.70p	6.30p	6.20p
Special dividend per Ordinary Share			37.14p		

Consolidated Income Statement Data continued

	Years ended December 31				
	2002	2001	2000	1999	1998
(£ million, except per Ordinary Share and per ADS amounts)					
Diluted earnings per Ordinary Share(i):					
Continuing operations	13.75p	8.05p	8.19p	5.94p	3.57p
Discontinued operations		3.44p	11.23p	1.99p	2.32p
Total	13.75p	11.49p	19.42p	7.93p	5.89p
Basic earnings per ADS(ii):					
Continuing operations	138.7p	81.3p	82.5p	59.7p	35.8p
Discontinued operations		34.7p	113.1p	20.0p	23.2p
Total	138.7p	116.0p	195.6p	79.7p	59.0p
Diluted earnings per ADS(ii):					
Continuing operations	137.5p	80.5p	81.9p	59.4p	35.7p
Discontinued operations		34.4p	112.3p	19.9p	23.2p
Total	137.5p	114.9p	194.2p	79.3p	58.9p

Consolidated Balance Sheet Data

	December 31				
	2002	2001	2000	1999	1998
(£ million)					
Amounts in accordance with UK GAAP:					
Total current assets	532.7	525.4	533.8	616.2	570.9
Intangible fixed assets	317.2	187.8	153.8	66.0	28.3
Property, plant and equipment	255.8	245.0	251.1	270.5	291.7
Investment in associated undertaking	8.5				
Investment in joint venture	115.0	114.0			
Fixed asset investments	8.2	25.7	24.0	16.6	14.4
Total assets	1,237.4	1,097.9	962.7	969.3	905.3
Total current liabilities	(461.5)	(428.5)	(404.0)	(370.4)	(375.6)
Loans (due after more than one year)	(164.2)	(161.2)	(165.1)	(15.9)	(8.5)
Liabilities (due after more than one year)	(6.3)	(8.3)	(22.1)	(4.3)	(4.3)
Provisions for liabilities and charges	(88.1)	(95.3)	(103.5)	(87.9)	(31.4)
Ordinary shareholders equity(iv)	517.3	404.6	268.0	490.8	485.5

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Share capital(iii)	113.5	113.1	112.4	111.8	111.4
Amounts in accordance with US GAAP:					
Goodwill, net of amortization	317.6	247.0	236.5	168.2	193.0
Other intangible fixed assets	150.1	56.2	55.8	64.3	35.7
Total assets	1,356.9	1,170.4	1,087.4	1,127.7	1,094.4
Total shareholders' equity	579.5	533.2	457.9	733.4	705.3

- (i) Diluted earnings per Ordinary Share is calculated on the weighted average of 934 million shares (2001 930 million shares, 2000 1,041 million shares, 1999 1,121 million shares, 1998 1,117 million shares) after allowing for the allotment of shares under option schemes, with a corresponding adjustment to income for the after tax effect of interest.
- (ii) Each ADS represents ten Ordinary Shares.
- (iii) Included in Ordinary shareholders' equity.
- (iv) Ordinary shareholders' equity includes non-equity capital of £0.3 million in all five years presented.

Dividends

Smith & Nephew has paid dividends on its Ordinary Shares in each year since 1937. An interim dividend in respect of each fiscal year is normally declared in August and from 2002 onwards paid in November, and the final dividend for each year is normally recommended by the Board of Directors in the following February and paid in May after approval in April by shareholders at the Company's Annual General Meeting.

The Company has issued 268,500 5.50% Cumulative Preference Shares of £1 each, whose right to a dividend of 5.50% per annum is preferred over the rights to dividends of the holders of Ordinary Shares.

Future dividends of Smith & Nephew will be dependent upon future earnings, the future financial condition of the Group, the Board's dividend policy and the additional factors that might affect the business of the Group set forth in Special Note Regarding Forward-Looking Statements above and Risk Factors below.

The following table shows the ordinary dividends on each Ordinary Share (as increased by the associated UK tax credit, but before deduction of withholding taxes) for the fiscal years 1998 through 2002. The associated UK tax credit was reduced from 20% to 10% for dividends paid on or after April 6, 1999. Approval by shareholders of the 2002 final dividend will be sought at the Annual General Meeting to be held on April 29, 2003. If approved by shareholders, this dividend will be payable on May 16, 2003 and will be paid as an ordinary dividend. The ordinary dividends, which are declared in pence per share in respect of each fiscal year, have been translated into US cents per share at the Noon Buying Rate at each respective payment date.

	Years ended December 31				
	2002	2001	2000	1999	1998
Pence per share:					
Interim	2.000	1.944	1.889	2.778	3.000
Final	3.330	3.222	3.111	4.444	4.222
Total	5.330	5.166	5.000	7.222	7.222
US cents per share:					
Interim	3.155	2.753	2.714	4.516	4.974
Final	5.162(i)	4.611	4.459	7.048	6.786
Total	8.317	7.364	7.173	11.564	11.760

(i) Translated at the Noon Buying Rate on April 7, 2003 of US\$ 1.550 = £1. This is equivalent to US\$ 0.516 per ADS.

On August 11, 2000, a special dividend of £415.6 million (41.27p per old ordinary 10p share, including tax credit, equivalent to US\$6.21 per ADS) was paid.

In 1998, the Company implemented a dividend re-investment plan that offers shareholders the opportunity to invest cash dividends in Ordinary Shares purchased in the market.

Exchange Rates

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The following table sets forth, for the periods and dates indicated, the Noon Buying Rates expressed in US dollars per £1:

	<u>High</u>	<u>Low</u>
Month:		
April 2003 (through April 7)(i)	1.58	1.55
March 2003	1.61	1.56
February 2003	1.65	1.57
January 2003	1.65	1.60
December 2002	1.61	1.56
November 2002	1.59	1.54
October 2002	1.57	1.54

(i) As of April 7, 2003, the latest practicable date, the Noon Buying Rate was 1.550.

	<u>Year end</u>	<u>Average(ii)</u>	<u>High</u>	<u>Low</u>
Fiscal year:				
1998	1.66	1.66	1.87	1.33
1999	1.61	1.62	1.67	1.60
2000	1.49	1.51	1.65	1.40
2001	1.45	1.44	1.50	1.37
2002	1.61	1.51	1.61	1.41

(ii) The average of the Noon Buying Rates on the last day of each month during the fiscal year.

RISK FACTORS

This section describes some of the risks that could affect the Group's businesses. The factors below should be considered in connection with any forward-looking statements in this Form 20-F and the cautionary statements contained in the Introduction on page 2.

Smith & Nephew's products are not in life support activities and in general are unlikely to threaten life. But, if they malfunctioned, they could damage or impair the repair of body functions. Management believes that the Group's quality, regulatory and medical controls and insurance activities are adequate and appropriate for this class of products. The Company's reputation is crucially dependent on strong performance in this area and on appropriate crisis management if a serious medical incident or product recall should occur.

The Board of Directors of Smith & Nephew is responsible for the maintenance of the Group's systems of risk management and internal control and for reviewing their effectiveness. An ongoing process has been in place for the full year identifying, evaluating and managing key risks through a Risk Committee, that comprises GEC members, which reports to the Board of Directors annually, and by a system of functional reports to the Board of Directors and the review of internal financial controls by the Audit Committee. These procedures are designed to identify and manage those risks that could adversely impact the achievement of the Group's objectives. While they do not provide absolute assurance against material misstatements or loss, the Directors, following a review of the systems described, are of the opinion that proper systems of risk management and internal control are in place within the Group.

The Group is insured against product, employers' and directors' and officers' liabilities and physical and consequential loss, subject to limits and deductibles. The Group maintains liability reserves to cover known uninsured risks.

The risks below are not the only ones that the Group faces. Some risks are not yet known to the Group and some risks that the Group does not currently believe to be material could later turn out to be material. All of these risks could materially affect the Group's business, its revenues, operating income, net assets, liquidity and resources.

The Group is reliant on the effective implementation of its strategy

The Group may encounter market conditions or other challenges to the implementation of its strategy that could result in the Group not meeting its shareholders' expectations of income or growth.

The Group is reliant on new technology

The Group operates in the medical device industry, which has a rapid introduction rate of new products. There is a risk to sales growth unless sufficient new products are introduced to the market place in a timely manner. There is also a risk of product (and in certain cases associated facilities) obsolescence.

New products developed and marketed by competitors may affect price levels in the Group's markets and may result in products being replaced over time. The Group's ability to develop and market new products acceptable to the market place is a key factor in maintaining its competitive position.

The Group is dependent on trends in healthcare expenditure

Changes in healthcare policy by governments or reimbursement authorities in major countries around the world can result in changes to the revenues of one or more of the Group's product lines. The Group is also dependent on the continued growth in surgical procedures.

The Group is exposed to product liability and patent infringement claims

Because of the nature of the Group's business, it is subject to a relatively high risk of product liability claims. The Group maintains product liability insurance, but this insurance is subject to limits and deductibles. In addition, insurance premiums are relatively high, particularly for US coverage, and there is a risk, at the industry level, of coverage becoming increasingly costly. The Group is also exposed to the potential for patent infringement claims, particularly because of the technological nature of medical devices.

The Group is exposed to risk of competitor consolidation

The markets in which the Group operates each contain a number of different major international competitors. The merger or consolidation of two or more of these competitors could impact the Group's strategic position.

The Group is exposed to regulatory approvals and controls

The medical device industry is highly regulated. Regulatory requirements are a major factor in determining whether substances and materials can be developed into marketable products and the amount of time and expense that should be allotted to such development. At any time the Group is awaiting a number of regulatory approvals, which if not received, could adversely affect results of operations.

The Group is exposed to political, economic and currency fluctuations

Because the Group has operations in many countries, political and economic developments in those countries or in the regions surrounding those countries may impact the Group's results of operation. Terrorist activities and ongoing global political uncertainties, including conflict in the Middle East, could adversely impact the Group. In addition, political changes in a country could prevent the Group from receiving remittances of profit from a member of the Group located in that country or from selling its investments in that country. Fluctuations in interest rates and currency exchange rates particularly between sterling and the US dollar and between the currencies in which its international operations or investments operate, could adversely affect the Group's earnings and the value of these businesses. Also, see the discussion of exchange and interest rate risk in Item 5 Operating and Financial Review and Prospects.

The Group is exposed to credit risk arising from financial instruments

The Group is subject to credit risk on cash, deposits and derivative instruments in the event of the non-performance of its counterparties.

The Group is dependent upon recruiting and retaining key personnel

In order to develop, support and market the products offered by the Group, it is necessary to hire and retain highly skilled employees with particular expertise. The implementation of the Group's strategic business plans could be undermined by failure to recruit or retain key personnel.

The Group is reliant on its reputation

An event that materially damaged the reputation of the Group or one or more of the its brands could have an adverse impact on subsequent revenues.

The Group is reliant on certain suppliers

The Group is reliant on certain key suppliers of raw materials; forgings and stampings for orthopaedics, optical and electronic subcomponents for endoscopy and active ingredients and products for advanced wound management. If these suppliers were unable to supply, there could be an adverse effect on the Group's results.

The Group is reliant on eight main manufacturing facilities

The Group has manufacturing production concentrated at eight main facilities in Memphis, Tennessee, Andover and Mansfield, Massachusetts, Oklahoma City, Oklahoma, Palo Alto and La Jolla, California and Largo, Florida in the United States and Hull in the United Kingdom for its businesses of orthopaedics, endoscopy and advanced wound management. If major physical disruption took place at any of these sites, it would adversely affect the results of operations. Physical loss and consequential loss insurance is carried to cover such risks subject to limits and deductibles.

The Group is dependent upon successfully integrating any businesses that it acquires

The Group has in the past and expects to pursue in the future acquisitions or alliances to complement its existing businesses. These types of transactions involve numerous risks, including successfully integrating acquired businesses, any of which could adversely affect the Group's results.

The Group is exposed to the risk that the investment values of its pension plans may not eventually be sufficient to meet pension obligations

The Group has two major defined benefit pension plans that are funded by investment assets. To the extent that pension liabilities and investment returns accrue at rates different to those presently assumed, unplanned funding obligations could occur.

ITEM 4 INFORMATION ON THE COMPANY

HISTORY AND DEVELOPMENT OF THE COMPANY

Group Overview

Smith & Nephew is a global company that concentrates on the development and marketing of medical devices in the three growth sectors of orthopaedics, endoscopy and advanced wound management. These three businesses comprise the Group's Ongoing Operations segment.

The Group's activities have a history dating back 147 years to the family enterprise of Thomas James Smith who opened a small drugstore in Hull, England in 1856. On his death in 1896, his nephew Horatio Nelson Smith took over the management of the business. The Company is a public limited company incorporated in Great Britain registered in, and operating under the laws of, England and Wales. Operations undertaken in countries other than the United Kingdom are under the laws of those countries in which they reside. The Company was incorporated and listed on the London Stock Exchange in 1937. In November 1999, the Company was listed on the New York Stock Exchange. The corporate headquarters is in the United Kingdom and the registered address is:

Smith & Nephew plc

15 Adam Street

London

WC2N 6LA

Tel: +44 (0) 20 7401 7646

Internet address: www.smith-nephew.com

Information contained on our website is not intended to be, and should not be regarded as being, part of this annual report on Form 20-F.

In June 2001, Smith & Nephew became a constituent part of the FTSE 100 index in the United Kingdom. This means that the Group is included in the top 100 companies traded on the London Stock Exchange measured in terms of market capitalization.

Recent Developments

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In January 2000, Smith & Nephew acquired the collagenase advanced woundcare business from BASF Pharma for £74 million. Results of this acquisition are reflected in Ongoing Operations from the date of acquisition.

In June 2000, Smith & Nephew sold its consumer healthcare business for a net cash consideration of £210 million.

In April 2001, Smith & Nephew transferred its casting and bandaging and traditional woundcare businesses to a 50/50 joint venture with Beiersdorf AG, known as BSN Medical. Results of the businesses contributed to the joint venture by Smith & Nephew prior to April 1, 2001 are reflected in Operations contributed to the joint venture within Continuing operations. Beginning April 1, 2001, Smith & Nephew accounted for the results of the joint venture using the gross equity method.

In April 2001, Smith & Nephew acquired the advanced woundcare business of Beiersdorf AG for £30 million. Results of this business are reflected in Ongoing Operations commencing from the date of acquisition.

In May 2001, Smith & Nephew acquired the anti-microbial woundcare business of Westaim BioMedical Corporation for an initial consideration of £12 million. Results of this acquisition are reflected in Ongoing Operations from the date of acquisition.

In June 2001, Smith & Nephew sold its ear, nose and throat business for a net cash consideration of £62 million to Gyrus plc. This business is classified in the Group's profit and loss accounts as Discontinued.

In March 2002, Smith & Nephew disposed of its rehabilitation business to AbilityOne Corporation (AbilityOne), a leading supplier in the US of rehabilitation products to hospitals, nursing homes and clinics, doing business as SammonsPreston. Smith & Nephew received £71 million in cash and a 21.5% equity interest in the combined company. Results of this business are classified as Discontinued. Beginning April 1, 2002, Smith & Nephew's equity interest in AbilityOne was accounted for using the net equity method.

In March 2002, Smith & Nephew expanded its endoscopy business by acquiring ORATEC Interventions, Inc., (ORATEC), a medical device innovator in the use of controlled radio frequency energy to treat joint and spine disorders, for net £191 million. Results of this acquisition are reflected in Ongoing Operations from the date of acquisition.

In November 2002, Smith & Nephew acquired the interests it did not already own in the joint arrangements it had with Advanced Tissue Sciences Inc., (ATS) for net £8 million. The principal arrangement relates to intellectual property rights to technology to develop products for the treatment of diabetic foot ulcers and the other wound indications.

On March 20, 2003, Smith & Nephew entered into an agreement with Centerpulse AG (the Combination Agreement), a public company incorporated under the laws of Switzerland (Centerpulse), and an agreement with InCentive Capital AG (the InCentive Agreement), a public company incorporated under the laws of Switzerland (InCentive) which holds, or has the right to acquire, approximately 19% of the issued share capital of Centerpulse. It is contemplated by the Combination Agreement and the InCentive Agreement that Smith & Nephew Group plc (Smith & Nephew Group), a new holding company for Smith & Nephew, will seek to acquire all outstanding shares of Centerpulse, a leading medical technology group, which serves the reconstructive joint, spinal and dental implant markets, in the following manner:

Smith & Nephew shareholders will exchange their Smith & Nephew shares for shares in Smith & Nephew Group on a one-for-one basis by means of a Court-approved scheme of reorganization.

Smith & Nephew Group will make a recommended offer to acquire each share of Centerpulse in exchange for 25.15 new Smith & Nephew Group shares and CHF 73.42 in cash.

Smith & Nephew Group will make a recommended offer to acquire each share of InCentive in exchange for new Smith & Nephew Group shares and cash that will mirror InCentive's holdings of Centerpulse shares, as adjusted for the adjusted net asset value of InCentive (excluding the Centerpulse shares held by it). Incentive will not accept the offer to Centerpulse Shareholders for the holding of its Centerpulse shares.

Successful completion of the offers for Centerpulse and InCentive is expected to result in the issuance of approximately 298 million new Smith & Nephew Group shares and the payment of approximately a net £400 million (CHF 870 million) in cash, after taking account of InCentive's expected cash balances. Shareholders of Centerpulse and InCentive will own approximately 24% of the outstanding shares of Smith & Nephew Group. Shares of Smith & Nephew Group are expected to be traded on the London Stock Exchange and ADSs representing Smith & Nephew Group shares are expected to be traded on the New York Stock Exchange. Smith & Nephew Group will also seek a secondary listing of its shares on the SWX Swiss Stock Exchange.

As part of the transaction, Smith & Nephew Group will assume Centerpulse's outstanding net debt which stood at CHF 358 million (£161 million) at December 31, 2002.

Both the Centerpulse and InCentive offers are conditional, inter alia, on the approval of Smith & Nephew's shareholders, on the court-approved scheme having become effective, the shares of Smith & Nephew Group plc being listed on the London Stock Exchange and on regulatory clearances. The transactions are expected to be completed in July 2003.

Group Structure

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Smith & Nephew operates on a worldwide basis. This has been achieved through a series of acquisitions, predominantly in the United States but also in Europe, and through continued emphasis on the development and introduction of new products in the Group's principal markets.

Smith & Nephew is organized into the three global business units of orthopaedics, endoscopy and advanced wound management and the Indirect Market Unit. Each global business unit manages its sales directly in ten international markets – the United States, Canada, the United Kingdom, Germany, Japan, Australia, France, Italy, New Zealand and Ireland – and takes full responsibility for strategy, research and development (R&D), manufacturing, marketing, sales and financial performance. The remaining 20 principal markets in which the Group has selling companies are managed by country managers, with business responsibility for the whole of the Group's product range, and comprise the Indirect Market Unit.

BUSINESS OVERVIEW

Activities and Geographical Markets

The tables below show the Group's total revenues for its fiscal years 2002, 2001 and 2000 analyzed by activity and by geographical origin:

	Years ended December 31		
	2002	2001	2000
	(£ million)		
Sales			
By activity			
Orthopaedics	470.2	404.6	335.0
Endoscopy	291.8	252.8	216.4
Advanced wound management	321.7	285.6	221.5
	<u>1,083.7</u>	<u>943.0</u>	<u>772.9</u>
Ongoing operations	1,083.7	943.0	772.9
Operations contributed to the joint venture		35.3	138.6
	<u>1,083.7</u>	<u>978.3</u>	<u>911.5</u>
Continuing operations	1,083.7	978.3	911.5
Discontinued operations	26.2	103.4	223.2
	<u>1,109.9</u>	<u>1,081.7</u>	<u>1,134.7</u>
Group sales by geographical origin			
United Kingdom	179.6	162.9	148.9
Continental Europe	250.7	199.6	159.7
United States	702.1	641.3	515.9
Other America	28.6	31.8	25.8
Africa, Asia and Australasia	144.3	133.5	125.3
	<u>1,305.3</u>	<u>1,169.1</u>	<u>975.6</u>
Operations contributed to the joint venture		35.3	138.6
	<u>1,305.3</u>	<u>1,204.4</u>	<u>1,114.2</u>
Continuing operations	1,305.3	1,204.4	1,114.2
Discontinued operations	26.2	103.4	223.2
	<u>1,331.5</u>	<u>1,307.8</u>	<u>1,337.4</u>
Less intragroup sales	(221.6)	(226.1)	(202.7)
	<u>1,109.9</u>	<u>1,081.7</u>	<u>1,134.7</u>
	<u>1,109.9</u>	<u>1,081.7</u>	<u>1,134.7</u>
	<u>1,109.9</u>	<u>1,081.7</u>	<u>1,134.7</u>
	<u>1,109.9</u>	<u>1,081.7</u>	<u>1,134.7</u>

	_____	_____	_____
	(£ million)		
Operating Profit			
By activity			
Orthopaedics	98.2	87.9	69.1
Endoscopy	53.8	46.8	38.2
Advanced wound management	44.0	36.1	33.4
	_____	_____	_____
Ongoing operations before goodwill amortization and exceptional items	196.0	170.8	140.7
Amortization of goodwill	(17.5)	(10.4)	(6.9)
Exceptional items	(29.9)	(19.3)	(3.8)
	_____	_____	_____
Ongoing operations	148.6	141.1	130.0
Operations contributed to the joint venture: operating profit		3.6	16.2
Operations contributed to the joint venture: exceptional items		(1.8)	(8.6)
	_____	_____	_____
Continuing operations	148.6	142.9	137.6
Discontinued operations: operating profit	2.1	11.1	29.0
Discontinued operations: exceptional items			(3.9)
	_____	_____	_____
	150.7	154.0	162.7
	_____	_____	_____

	Years ended December 31		
	2002	2001	2000
	(£ million)		
Operating profit by geographical origin			
United Kingdom	21.7	19.6	24.4
Continental Europe	21.1	18.0	12.5
United States	129.8	113.3	82.2
Other America	(0.7)	0.9	3.3
Africa, Asia and Australasia	24.1	19.0	18.3
Amortization of goodwill	(17.5)	(10.4)	(6.9)
Exceptional items	(29.9)	(19.3)	(3.8)
Ongoing operations	148.6	141.1	130.0
Operations contributed to the joint venture: operating profit		3.6	16.2
Operations contributed to the joint venture: exceptional items		(1.8)	(8.6)
Continuing operations	148.6	142.9	137.6
Discontinued operations: operating profit	2.1	11.1	29.0
Discontinued operations: exceptional items			(3.9)
	150.7	154.0	162.7

Ongoing Operations Overview

In 2002, ongoing operations contributed 100% of sales and operating profits from continuing operations. Revenues for the last three fiscal years were:

Years ended December 31				Years ended December 31		
2002	2001	2000		2002	2001	2000
(Percent)				(£ million)		
43	43	43	Orthopaedics	470.2	404.6	335.0
27	27	28	Endoscopy	291.8	252.8	216.4
30	30	29	Advanced wound management	321.7	285.6	221.5
100	100	100		1,083.7	943.0	772.9

Ongoing Operations Orthopaedics

Overview

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Orthopaedic products comprise reconstructive implants, trauma products and clinical therapies. Reconstructive implants include hip, knee and shoulder joints as well as accessory products such as bone cement and mixing systems used in cemented joint replacement surgery. Trauma products consist of internal and external fixation devices, used in the stabilization of severe fractures. Clinical therapies consist of products applied in an orthopaedic office/clinic setting and currently include bone growth stimulators and a joint fluid therapy product.

The orthopaedics business is managed worldwide from Memphis, Tennessee, where the Group has its main manufacturing facility. Orthopaedic implants and trauma products are also manufactured at a small facility in Tuttlingen, Germany.

The Group's knee replacement business is built on two major knee systems: GENESIS II designed to facilitate the accuracy and efficiency of the operating procedure and provide improved long-term clinical results; and PROFIX, a knee replacement system featuring simpler instruments and surgical technique. The Group has recently developed and manufactures knee implant components made from oxidized zirconium (OXINIUM) which management believes have improved wear properties which will be of significant benefit to younger, more active patients. Within the total hip product line, SPECTRON cemented hip system and the REFLECTION acetabular cup system have documented positive long term clinical performance. More recently, the success of SYNERGY, a tapered titanium stem system, and ECHELON, a revision stem system, have established Smith & Nephew as a strong player in this product segment.

Products such as the RUSSELL-TAYLOR, IMHS and TRIGEN intramedullary nail systems and the AMBI and CLASSIC compression hip screws provide trauma surgeons with a comprehensive management system for a wide variety of fractures. The ILIZAROV and the TAYLOR SPATIAL FRAME external fixator systems provide limb strengthening and deformity correction.

The EXOGEN ultrasonic bone healing stimulator and SUPARTZ hyaluronic acid joint injections are the main products in the clinical therapies sector.

To compete effectively in the growing global orthopaedic market, management believes that it is important to have a skilled sales force that can build strong relationships with surgeons and to have a leading edge product range. Smith & Nephew has thus expanded its sales force by 12% in 2002, attracting skilled orthopaedic sales people with deep understanding of their products.

Strategy

Smith & Nephew's strategy is for future growth through product development in its existing core business and expansion into the fast-growing market for less invasive therapies. Management believes that the orthopaedic market will continue to grow for the foreseeable future. This is largely attributable to the increase in the over age 65 population and the increasing need for total joint replacement products and other orthopaedic therapies in younger more active patients.

Smith & Nephew also intends to further penetrate the joint reconstruction market by leveraging its portfolio of products and services, and by introducing less invasive and alternative therapies, products and technologies. Management is working to accelerate the Group's growth in the trauma market and reconstructive markets by making effective use of new products such as its Image Guided Surgery applications. The Group is also contributing to patient education and empowerment through its websites.

New Products

In 2002, the orthopaedics business continued to introduce OXINIUM technology across the knee product line, including the introduction of macrotextured components in the GENESIS II and PROFIX knee systems. The Group also introduced the ACCURIS minimally invasive unicompartmental knee system. In February 2003, the OXINIUM femoral head was launched in the hip market. OXINIUM technology expands the range of hip and knee implants with a low wear material that a surgeon can select.

In 2002, the Group launched ORTHOGUARD anti-microbial pin sleeves designed to address pin tract infection which management believes is a significant complication in external fixation. The EXOGEN 3000 unit was also introduced in 2002 as a more compact unit with a fixed treatment cycle. This ultrasound healing device targets the fracture at risk category.

Regulatory Approvals

In February 2002, the Company received the first 510K clearance by the FDA for Fluoroscopic Image Guided knee surgery instrumentation. This was followed by clearance for trauma instrumentation in October 2002 and hip instrumentation in December 2002. Image guided instrumentation (branded ACHIEVE) is a key part of management's strategy towards less invasive orthopaedic surgery.

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In May 2002, the FDA issued 510K clearance for instrumentation associated with the ACCURIS system. ACCURIS instrumentation and technique are used in minimally invasive unicompartmental knee surgery.

In July 2002, the FDA issued 510K clearance for ORTHOGUARD anti-microbial pin sleeves. This is the first FDA clearance of an antibiotic impregnated adjunctive orthopaedic device. This device is intended to inhibit bacterial colonization around orthopaedic pins and wires.

Competition

Management estimates that the worldwide orthopaedic market served by the Group grew by 13% in 2002 and is currently worth more than £5.2 billion per annum. Management believes that Smith & Nephew holds an 8% share of this market. Market share gains were achieved in the hip, knee and trauma categories in 2002 due to a comprehensive product portfolio and 12% increase in the sales force.

There are a number of competitors in the orthopaedic market, principally Stryker/Howmedica, DePuy/Johnson & Johnson, Zimmer, Biomet, Synthes-Stratec and Centerpulse.

Ongoing Operations Endoscopy

Overview

Smith & Nephew's endoscopy business, headquartered in Andover, Massachusetts, develops and commercializes a range of endoscopic (minimally invasive surgery) techniques, educational programs and value-added services for surgeons to treat and repair soft tissue, articulating joints, vascular structures and spinal discs.

The Endoscopy business offers surgeons endoscopic technologies for surgery, including: fluid management and insufflation instruments for surgical access; digital cameras, digital image capture, central control, multimedia broadcasting, scopes, light sources and monitors to assist with visualization; radiofrequency wands, electromechanical and mechanical blades, and hand instruments for resecting tissue; and specialized devices, fixation systems and bioabsorbable materials to repair damaged tissue.

Manufacturing facilities are located in Andover and Mansfield, Massachusetts; Oklahoma City, Oklahoma; and Palo Alto, California. Major service centers are located in the United States, the United Kingdom, Germany, Japan and Australia.

Strategy

With the strategic intent of being a global leader for surgical techniques that reduce trauma and pain to the patient, reduce cost to the healthcare system and provide better outcomes for surgeons, management believes the endoscopy business capitalizes on the growing acceptance of endoscopy as a preferred surgical choice among physicians and patients.

To sustain growth and maintain its market position, the endoscopy business supports its strategy with surgeon education programs, financing solutions, global fellowship support, partnerships with professional associations and surgeon advisory boards. The Group is also enhancing its reputation for surgeon-focused innovation with its proprietary InVentures Bioskills Lab program, which enables surgeons to work directly with a Smith & Nephew multi-disciplined team to develop concepts and explore the commercialization of their techniques or instrumentation. The Group also works closely with leading institutions to design and develop Digital Operating Rooms, which help to improve productivity and efficiency in surgery. In addition, Smith & Nephew also works with surgeons and the media on local, regional and global levels to provide information on new products and techniques directly to consumers.

In March 2002, Smith & Nephew expanded its endoscopy business by acquiring ORATEC Interventions, Inc., a medical device innovator in the use of radiofrequency thermal energy to treat joint and spine disorders through the cutting, removal, ablation or modification of damaged or stretched tissue. Management believes that this will establish the Group as a leader in radiofrequency technology for minimally invasive surgery and provide other endoscopic opportunities in a market segment that management believes is globally worth £75 million and growing at 10% annually.

New Products

In 2002, Smith & Nephew introduced the DYONICS ELECTROBLADE RESECTOR which provides simultaneous resection and coagulation of soft tissue. The Group also introduced TWINFIX SUTURE ANCHORS, a specialized shoulder repair system for rotator cuff injuries available in both bioabsorbable and metal anchor versions.

In 2002, Smith & Nephew introduced a decompression catheter for lower back and leg pain associated with bulging or contained herniated discs. The Group also introduced a bipolar cutting and ablation system for the VULCAN system radiofrequency generator and the SAPHYRE BIPOLAR ABLATION PROBE for thermal modification of soft tissue.

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Smith & Nephew also introduced its Digital OR program, an integrated and fully functional operating room suite utilizing central control, information and image management, multi-media broadcast and other endoscopic equipment that management believes enables hospitals and surgical centers to maximize performance.

Regulatory Approvals

During 2002, the endoscopy business obtained clearance/approval for the following products in all major markets, with the exception of Japan, where the approval cycle is traditionally slower: the DYONICS ELECTROBLADE RESECTOR combining mechanical and radio frequency resection technologies; a bioabsorbable version of the TWINFIX shoulder anchor and a new operative Hysteroscopy; and central control capability for the 635 Digital Image Management System.

Competition

Management estimates that the global endoscopy market is worth £3.0 billion a year and is growing at 6% annually, driven by increasing numbers of sports injuries, longer and more active lifestyles, a desire for minimally invasive procedures, innovative technological developments and a need for cost effective procedures. Management believes that Smith & Nephew has a 35% share in the arthroscopy sector.

Smith & Nephew's main competitors, which vary according to the endoscopic specialties, include Arthrex, Arthrocare, Johnson & Johnson, Linvatec/Conmed and Stryker.

Ongoing Operations Advanced Wound Management

Overview

Smith & Nephew's advanced wound management business is headquartered in Hull, England. It supplies a range of products and clinical support services for the treatment of chronic and acute skin wounds. It offers a range of products from initial wound bed preparation through to full wound closure. These products are targeted particularly at chronic wounds connected with the elderly, such as pressure sores, venous leg and diabetic foot ulcers, and also serious burns.

Advanced wound management products are manufactured in facilities in Hull and Gilberdyke, England; Largo, Florida and La Jolla, California and by certain third party manufacturers.

The Group has continued to build its sales and marketing infrastructure in the world's major markets with increased investment in sales teams, particularly in Japan and France in 2002, and behind global brand development. These initiatives have led to increased levels of demand on the Group's manufacturing and global supply chain, which are being addressed with increased investment in the facilities in Hull, Gilberdyke and Largo.

Strategy

The Group's strategy for future wound management products and sales growth focuses on three treatment areas: wound assessment, wound bed preparation and active healing. Smith & Nephew's joint venture with Beiersdorf AG, BSN Medical, acquired the Group's traditional woundcare business effective April 1, 2001, allowing the advanced wound management business to focus its attention on higher added value advanced woundcare products.

In November 2002, the Group acquired 100% of its former joint arrangements with ATS to apply human tissue technology to the treatment of all skin wounds. The transaction has brought the full costs and benefits of two significant products, DERMAGRAFT and TRANSCYTE, into the Group. DERMAGRAFT is a human dermal replacement designed as a treatment for diabetic foot ulcers. TRANSCYTE is a temporary wound covering for the treatment of burns.

The Group has continued to build its sales and marketing infrastructure in the world's major markets, both through the investment in the Group's existing network and through the additional sales teams the Group has gained through its acquired businesses in recent years. The integration of the acquired sales forces has increased the Group's capability throughout the world, particularly in the key markets of the United States and Germany.

New Products

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Management believes that the future lies in advanced products with their ability to accelerate healing rates, reduce hospital stay times and cut the cost of nursing time and aftercare in the home. Research and development has been organized to address this opportunity and expenditure is over 5% of advanced wound management product sales.

During 2002, the business has utilized its network of selling companies to launch ACTICOAT worldwide. ACTICOAT, acquired from Westaim of Canada in May 2001, is an antimicrobial barrier dressing incorporating nanocrystalline silver used in the treatment of burns or wounds. The silver reduces the risk of bacterial colonization and acts to kill micro-organisms that can cause infection and prevent or retard healing.

During 2002, the Group launched an improved ALLEVYN adhesive hydrocellular dressing. Management believes that ALLEVYN is the largest selling dressing in its category in the world and that new shapes and designs will aid Smith & Nephew in maintaining this position. Also during the year, an improved design of the OPSITE POST-OP range was launched. OPSITE POST-OP is a water-resistant, post-operative dressing that management believes is the global market leader.

In 2002, the Group launched DERMAGRAFT in the United States. Management believes that 88% of the outpatient population have been approved for Medicare reimbursement coverage.

Regulatory Approvals

In October 2001, the FDA approved the application for a Pre-Marketing Approval (PMA) for DERMAGRAFT to be sold in the United States. DERMAGRAFT has already been launched in a number of markets, including Australia, South Africa and Canada. In April 2002, US national reimbursement codes were issued by the centers for Medicare and Medicaid Services enabling individual states to set reimbursement guidelines.

In December 2002, a European certificate for Class III medical device approval was issued for ACTICOAT. This will enable faster sales penetration of European markets.

Competition

Management estimates that the sales value of the advanced wound management market worldwide is £1.5 billion a year, growing at 12% annually, and that Smith & Nephew has a 21% market share. Growth is driven by an aging population and by a steady trade up to higher technology, higher margin products that are more clinically efficient and cost effective than their conventional counterparts. Management believes that, with over 50% of all wounds still treated with conventional dressings, there is a strong growth potential for advanced products.

Worldwide competitors in advanced wound management include Johnson & Johnson, the Convatec division of Bristol-Myers Squibb, 3M and Kinetic Concepts Inc.

Operations contributed to the joint venture

Operations contributed to the joint venture consist of the casting and bandaging and traditional woundcare businesses up until they were contributed to the joint venture with Beiersdorf AG on April 1, 2001. Beiersdorf AG contributed its casting and bandaging business and a complementary compression hosiery business. The joint venture is called BSN Medical. This is owned 50% by each parent company and is independently managed. BSN Medical is headquartered in Hamburg, Germany and has manufacturing facilities in the United States, the United Kingdom, Germany, France, the Republic of Ireland, South Africa, Mexico and Pakistan. BSN Medical is accounted for by Smith & Nephew under the gross equity method. In certain markets, Smith & Nephew's sales forces sell BSN Medical's products on an agency basis in return for an agency commission and in some markets, particularly in Asia, Smith & Nephew distributes products for BSN Medical.

Discontinued Operations

Discontinued operations in 2002 comprise three months of results of the rehabilitation business disposed of in March 2002. The rehabilitation business headquartered in Germantown, Wisconsin manufactured and marketed a wide range of devices and services to physiotherapists and occupational therapists to help patients recover from surgery or from a stroke.

Discontinued operations in 2001 comprise five months of results of the ear, nose and throat business disposed of in June 2001 and a full year of rehabilitation results. The ear, nose and throat business headquartered in Bartlett, Tennessee comprised a wide range of products for sinus surgery, as well as products focused on surgical procedures of the head and neck.

Discontinued operations in 2000 comprise six months of results of the consumer healthcare business disposed of in June 2000 and a full year of ear, nose and throat and rehabilitation results. The consumer healthcare business was aimed at the personal care market and owned a portfolio of leading brand names. Consumer healthcare products were marketed and sold by the Group, principally in the United Kingdom, but also in the Republic of Ireland, Canada, South Africa, Australasia and parts of Asia.

Joint Ventures, Associated Undertakings, Joint Arrangements and Other Interests

Associated undertakings are those in which the Group has a beneficial interest of 50% or less in the equity capital and where the Group exercises significant influence over commercial and financial policy decisions. In March 2002, the Group acquired 21.5% of AbilityOne Corporation as part of the transaction in which it disposed of its rehabilitation business to AbilityOne Corporation. Since April 1, 2002, this interest has been included in the Group's consolidated results as an associated undertaking and accounted for under the net equity method.

Smith & Nephew owns 50% of the BSN Medical joint venture, which became operational on April 1, 2001. In connection therewith, the Group contributed its associated undertaking in Venezuela (which acted as a licensee/manufacturer and distributor for Smith & Nephew products) to BSN Medical.

The Group has had an interest in two joint arrangements with ATS, relating to products for the treatment of diabetic foot ulcers (DERMAGRAFT) since 1996, and cartilage replacement (NEOCYTE) since 1994. On October 11, 2002, ATS filed a voluntary petition for reorganization under Chapter 11 of the US Bankruptcy Code. Immediately following this filing Smith & Nephew announced that it was petitioning the court concerned to allow it to acquire ATS's 50% share of the joint arrangements conducted with Smith & Nephew. On November 25, 2002, the Group purchased the interests it did not already own in the joint arrangements from ATS for net £7.8 million.

Raw Materials

Raw material purchases comprise principally optical and electronic sub-components, elastomeric products and metal forgings and stampings in respect of the ongoing businesses. Management believes that prices of principal raw materials purchased are not volatile. Finished goods purchased for resale are primarily collagenase and ACTICOAT in the advanced wound management business, cameras, monitors and electrical devices in the endoscopy business and SUPARTZ joint lubricant in the orthopaedic business.

Seasonality

Smith & Nephew's sales are generally at their highest in quarter four of any year and at their lowest in quarter three. This is caused by the relatively high number of accidents and sports injuries which occur in the North American and European winters which increases sales of orthopaedic and endoscopy products and by the deferral of elective surgery during the peak summer holiday periods in North America and Europe.

Marketing Channels

Smith & Nephew's customers are the various providers of medical and surgical services worldwide. In certain parts of the world, including the United Kingdom, much of Continental Europe, Australia, Canada and South Africa, these are largely governmental organizations funded by tax revenues. In the United States, the Group's major customers are public and private hospitals, many of which have combined to form large purchasing groups and receive revenue from private health insurance and governmental reimbursement programs. In the United States, Medicare is a major source of reimbursement for knee and hip procedures and for wound healing treatment regimes.

Competition exists among healthcare providers to gain patients on the basis of quality, service and price. In many countries, and particularly in the United States, providers are under pressure to reduce the total cost of healthcare delivery. There has been some consolidation in the Group's customer base, as well as among the Group's competitors, and these trends are expected to continue long term. Smith & Nephew competes against both specialized and multinational corporations, including those with greater financial, marketing and other resources.

The Group's customers reflect the wide range of distribution channels, purchasing agents and buying entities in over 90 countries worldwide. The largest single customer worldwide is the National Health Service in the United Kingdom. Sales to this customer in 2002 represented approximately 3% of the Group's worldwide total sales.

Regulatory Controls

The international medical device industry is highly regulated. Regulatory requirements are a major factor in determining whether substances and materials can be developed into marketable products and the amount of time and expense that should be allotted to such development.

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National regulatory authorities administer and enforce a complex series of laws and regulations that govern the testing, approval, manufacturing, labelling, marketing and sale of healthcare and pharmaceutical products. They also review data supporting the safety and efficacy of such products. Of particular importance is the requirement in many countries that products be authorized or registered prior to manufacture, marketing or sale and that such authorization or registration be subsequently maintained.

The trend in recent years has been towards greater regulation and higher standards of technical appraisal, which generally entail lengthy inspections for compliance with appropriate standards, including environmental laws and regulations such as good manufacturing practices. Smith & Nephew believes that these recent changes will not have a material adverse effect on the Group's financial condition and the results of operations. All significant facilities within the Group are subject to regular internal audit for compliance with national and Group standards and policies.

Additional information regarding the impact of environmental and other regulatory laws is included under the appropriate sections in Ongoing Operations above and Environmental Factors below.

Environmental Factors

The Group's manufacturing operations are subject to various environmental laws and regulations. Smith & Nephew believes that the Group's operations currently comply in all material respects with applicable environmental laws and regulations. Although the Group continues to make capital expenditures for environmental compliance, it does not anticipate any significant expenditures as a result of such laws and regulations that would have a material adverse impact upon the Group's financial condition.

The Group has an established environmental policy and operating committee reporting to a member of the Group's Executive Committee. The Group is committed to the protection of the environment wherever possible by using renewable resources and developing manufacturing processes and products to reduce any adverse effects on the environment.

Product Liability

The Group monitors the safety of its products from initial product development through to product use or application. In addition, the Group analyzes on a worldwide basis reports of adverse reactions and complaints relating to its products.

Product liability is a commercial risk for the industry of which the Group is a part, particularly in the United States where there are increasing numbers of claims involving medical devices. Smith & Nephew has implemented systems it believes are appropriate in respect of loss control techniques. These include reporting mechanisms to ensure early notification of complaints, a legal department which manages product liability claims and lawsuits and a committee, chaired by and containing clinicians independent of the Group, that advises on the safety of raw materials and products, and clinical standards and ethics.

To date, there have been no material instances of loss to the Group arising from product liability claims, nor has the development of strict liability within the European Community resulted in the Group receiving increased notifications of adverse incidents or claims. There are currently no individual product liability claims that are expected to have a material adverse effect on the Group's financial position. The Group believes that its product liability exposure is covered by insurance as far as practicable.

There can be no assurance that consumers, particularly in the United States, will not bring product liability or related claims that would have a material adverse effect on the Group's financial position in the future or that the Group will continue to resolve such claims within insurance limits as in the past in view of changing legal doctrines and attitudes regarding such matters.

ORGANIZATIONAL STRUCTURE

Overview

The Group has a structure under which global business units have responsibility for strategy, R&D, manufacturing, marketing, sales and financial performance in the ten markets of the United States, Canada, the United Kingdom, Germany, Japan, Italy, France, Australia, New Zealand and Ireland. With short and clear lines of communication, the structure makes each business responsive to its marketplace and able to grow. The remaining 20 principal markets in which the Group has selling companies are in Continental Europe, Asia, South Africa and Latin America and are managed by country managers and co-ordinated by a central team in London, England that reports to the Group Director for Indirect Markets.

A head office team in London, England supports the global business units, primarily in the areas of business development, company secretarial, finance, human resources and investor relations, with a legal department based in Memphis, Tennessee. A central research center in York, England is charged with the development of enabling technologies in both materials science and biology, particularly cell biology.

Principal Subsidiary Undertakings

The Group's principal operating subsidiary undertakings are as follows:

<u>Company Name</u>	<u>Activity</u>	<u>Country of operation and incorporation</u>	<u>% owned</u>
United Kingdom:			
Smith & Nephew Healthcare Limited	Medical Devices	United Kingdom	100%
Smith & Nephew Medical Limited	Medical Devices	United Kingdom	100%
T J Smith & Nephew Limited	Medical Devices	United Kingdom	100%
Continental Europe:			
Smith & Nephew GmbH	Medical Devices	Austria	100%
Smith & Nephew SA-NV	Medical Devices	Belgium	100%
Smith & Nephew A/S	Medical Devices	Denmark	100%
Smith & Nephew OY	Medical Devices	Finland	100%
Smith & Nephew SA	Medical Devices	France	100%
Smith & Nephew GmbH	Medical Devices	Germany	100%
Smith & Nephew Limited	Medical Devices	Ireland	100%
Smith & Nephew Srl	Medical Devices	Italy	100%
Smith & Nephew BV	Medical Devices	Netherlands	100%
Smith & Nephew A/S	Medical Devices	Norway	100%
Smith & Nephew Lda	Medical Devices	Portugal	100%
Smith & Nephew SA	Medical Devices	Spain	100%
Smith & Nephew AB	Medical Devices	Sweden	100%
Smith & Nephew AG	Medical Devices	Switzerland	100%

America:

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Smith & Nephew Inc	Medical Devices	Canada	100%
Smith & Nephew SA de CV	Medical Devices	Mexico	100%
Smith & Nephew Inc	Medical Devices	Puerto Rico	100%
Smith & Nephew Inc	Medical Devices	United States	100%
Africa, Asia and Australasia:			
Smith & Nephew Pty Limited	Medical Devices	Australia	100%
Smith & Nephew Limited	Medical Devices	Hong Kong	100%
Smith & Nephew Healthcare Limited	Medical Devices	India	100%
Smith & Nephew KK	Medical Devices	Japan	100%
Smith & Nephew Limited	Medical Devices	Korea	100%
Smith & Nephew Healthcare Sdn Berhad	Medical Devices	Malaysia	100%
Smith & Nephew Limited	Medical Devices	New Zealand	100%
Smith & Nephew Pte Limited	Medical Devices	Singapore	100%
Smith & Nephew Limited	Medical Devices	South Africa	100%
Smith & Nephew Limited	Medical Devices	Thailand	100%
Smith & Nephew FZE	Medical Devices	United Arab Emirates	100%

PROPERTY, PLANTS AND EQUIPMENT

The Group's principal locations are as follows:

Group Head Office in London, England;

Orthopaedics HQ and manufacturing facility in Memphis, Tennessee;

Endoscopy HQ and separate manufacturing facility in Andover, Massachusetts. Other manufacturing locations are in Mansfield, Massachusetts, Oklahoma City, Oklahoma and Palo Alto, California; and

Advanced wound management HQ and manufacturing facility in Hull, England and manufacturing facilities in Largo, Florida and La Jolla, California.

In 2002, the Endoscopy HQ facility was leased and the Palo Alto facility was added through the ORATEC acquisition. Additional manufacturing capacity was added to the existing facilities in Memphis and Mansfield.

The manufacturing facilities in Memphis, Andover, Hull and Largo are freehold while all other principal manufacturing locations and the Group Head Office are leasehold. The Group also has freehold and leasehold interests in real estate in many countries throughout the world, but none is significant individually to the Group as a whole.

The Group considers its existing facilities, combined with the planned expansion of these facilities, to be adequate to meet anticipated demands for its products. Where required, the appropriate governmental authorities have approved the existing facilities.

ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OPERATING RESULTS

Accounting Principles

The following discussion and analysis is based upon, and should be read in conjunction with, the consolidated financial statements of Smith & Nephew included elsewhere in this Annual Report. The Group's Financial Statements are prepared in accordance with UK GAAP, which differ in certain respects from US GAAP. Reconciliations reflecting the effect of the significant differences between UK GAAP and US GAAP are set forth in Note 35 of the Notes to the Financial Statements.

New Accounting Policies in 2002

The Group discloses the additional information required under Financial Reporting Standard 17 (FRS 17) regarding defined benefit pension plans; this is to be found in Item 18 Financial Statements in Note 29 of the Notes to the Financial Statements. The significant difference to existing practice is that pension liabilities are discounted at risk free interest rates as against long run investment return rates.

Critical Accounting Policies

The following policies are considered to be critical to the reporting of the Group's results:

Intangible fixed assets

Goodwill, representing the excess of purchase consideration over fair value of net assets acquired prior to December 31, 1997, was set off against reserves in the year of acquisition. Goodwill acquired since January 1, 1998 is capitalized and amortized on a straight line basis over its estimated useful economic life, up to a presumed maximum of 20 years, except for goodwill arising on the formation of the BSN Medical joint venture and acquisition of the Group's share of the AbilityOne associated undertaking, which is not amortized but is subject to an annual impairment review. This treatment, which is a departure from the requirement of the Companies Act to amortize goodwill, is adopted in order to show a true and fair view. Goodwill previously written off to reserves is added back for inclusion in the calculation of gains and losses on disposals. Under US GAAP, goodwill and other intangible fixed assets purchased prior to 2002 would have been capitalized and amortized over their expected useful lives. Commencing in 2002, goodwill would not be amortized and would be subject to an annual impairment review, whereas other intangible assets would continue to be capitalized and amortized over their useful lives.

The carrying value of goodwill and acquired intangibles is reviewed for impairment at the end of the first full financial year following acquisition and in other periods if significant events or changes in circumstances indicate the carrying value may be impaired.

Purchased patents, know-how, trade marks, licenses and distribution rights are capitalized as intangibles and amortized over a period not exceeding 20 years.

The carrying values of intangibles are reviewed for impairment when events or changes in circumstances indicate the carrying value may be impaired.

Tangible fixed assets

Tangible fixed assets are stated at cost and, except for freehold land, are depreciated as wasting assets. Freehold and long leasehold buildings are depreciated on a straight-line basis at between 1% and 5% per annum. Short leasehold land and buildings (leases of under 50 years) are depreciated by equal annual installments over the term of the lease.

Plant and equipment are depreciated over lives ranging between three and twenty years by equal annual installments to write down the assets to their estimated disposal value at the end of their working lives.

Financial Derivatives

Currency swaps to match foreign currency net assets with foreign currency liabilities are translated into sterling at year end exchange rates. Changes in the principal values of currency swaps are matched in reserves against changes in the values of the related assets. Interest rate swaps to protect interest costs and income are

accounted for as hedges. Changes in the values of interest rate swaps are recognized against interest in the period relating to the hedge.

Inflation

The Group operates internationally and in many different economic climates, but, in general, inflation has not had a material effect on the Group's results. The Group does not have material subsidiaries in any economies subject to hyperinflation.

Foreign Currencies

The Group protects its shareholders' funds by matching foreign currency assets, including acquisition goodwill, with foreign currency liabilities where practicable. These liabilities take the form of either borrowings or currency swaps. At December 31, 2002, the Group had gross borrowings of £316.1 million, mainly in foreign currency, and cash and bank balances of £22.5 million. Currency swaps amounted to £563.2 million payable, of which 73% were to redenominate internal borrowings into US dollars. Currency swaps of £579.9 million receivable have been netted off against the currency swaps payable, and the net balance of £16.7 million is included in the financial statements as £21.3 million in debit balances on currency swaps within debtors and £4.6 million in credit balances on currency swaps within other creditors. Translation movements on the Group's unmatched foreign currency net assets increased shareholders' funds by £9.1 million in 2002.

Fiscal 2002 compared with fiscal 2001

Group sales during fiscal 2002 amounted to £1,109.9 million, an increase of 3% when compared to fiscal 2001. After excluding sales of operations contributed to the joint venture and of discontinued operations, sales growth of ongoing operations was 15%. Of this growth, 14% points arose from underlying sales growth and 4% points arose from businesses acquired in 2002 and 2001 while currency translation had a 3% points negative effect. Selling price increases accounted for approximately 1% of sales growth.

Operating profit of ongoing operations before goodwill amortization and exceptional items was £196.0 million in 2002, a 15% increase over 2001. Operating profit of ongoing operations in 2002 was £25.2 million higher due to higher sales volumes and profits from businesses acquired. Profits arising from the acquisition of ORATEC contributed 2% points of the profit increase. Operating margin was unchanged at 18% with 0.5% of divestment dissynergies offset broadly by cost savings and leverage benefits.

The Group's share of joint venture sales at £155.0 million was £31.4 million higher than 2001 reflecting a full year's ownership compared with nine months in 2001 offset by the effect of product disposals made in January 2002. The Group's share of operating profit of BSN Medical increased from £12.8 million to £19.6 million, reflecting a full year of ownership and improved margins. The joint venture operating profit margin for 2002 was 12.6%, a 2% point increase from 2001 as a result of integration and rationalization benefits. The Group's share of rationalization costs of BSN Medical was £2.6 million.

The Group's share of the operating profit of the AbilityOne associated undertaking, that it acquired in March 2002, was £4.9 million. Operating profits arising from discontinued operations were £2.1 million in 2002 and operating profits of operations contributed to BSN Medical were £3.6 million in 2001.

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Profit before taxation, goodwill amortization and exceptional items of ongoing operations was £209.9 million in 2002, £29.0 million higher than 2001. Net interest expense was lower by £4.7 million due to lower interest rates.

Goodwill amortization increased by £7.1 million compared with 2001, £5.8 million of which is due to the ORATEC acquisition.

Operating exceptional items within ongoing operations of £29.9 million comprise £17.5 million for the write-down of the Group's trade investment in the common stock of ATS following its filing for bankruptcy; £4.0 million for further rationalization due to the contribution of businesses to BSN Medical; and £8.4 million for integration in connection with the acquisition of ORATEC and the Dermagraft joint arrangement.

Profit before taxation was £177.9 million, compared with £193.6 million in 2001. In 2002, profit before taxation included a gain on the disposal of the rehabilitation business of £18.0 million compared with a gain on the disposal of the ear, nose and throat business of £49.2 in 2001.

The underlying tax charge of £61.6 million represents 29% of profit before goodwill amortization and exceptional items, the same percentage as in fiscal 2001. The tax charge on net exceptional items was £4.2 million because there is no tax benefit on £30.0 million of goodwill deducted in the calculation of the gain on disposal of the rehabilitation business.

Basic earnings per share were 12.11p, a decrease on 2001 of 14%. Adjusted earnings per share before goodwill amortization and exceptional items were 16.02p, an increase on 2001 of 15%. Adjusting for the loss of profits caused by the disposal of the ear, nose and throat business in 2001 and the rehabilitation business in 2002 and the formation of the BSN Medical joint venture in 2001, earnings per share before goodwill amortization and exceptional items were 19% higher than 2001.

Management is not aware of any governmental, economic, fiscal, monetary or political policies or factors that have materially affected, directly or indirectly, the Group's operations or investments by shareholders.

Orthopaedics

Sales

Sales in the orthopaedics business increased by £65.6 million (16%) from £404.6 million in 2001 to £470.2 million in 2002. The negative effect of currency translation into sterling was 4% points and underlying sales grew by 20% points.

Sales in the United States increased by 23%. 7% points of this sales growth was due to the full year effect of the OXINIUM knee component and SUPARTZ hyaluronic acid, both new products launched during 2001. Sales of trauma products grew by 10%, hip implants by 13% and knee implants by 23%.

Outside the United States, the highest sales growth was in Australia and New Zealand at 23% caused by a government initiative to incentivize healthcare insurance in Australia and the appointment of a new agent in New Zealand. Sales in Italy grew 22% due to market share gains, particularly in knee implants, and sales in Germany grew by 15%, again due to gains in knee implants. Sales growth in Japan, the orthopaedics business's second largest market by sales value, was 6%.

On a worldwide basis, sales of hip implants grew by 17%, knee implants by 33% and trauma products by 10%.

Operating profit

Operating profit from the orthopaedics business before goodwill amortization and exceptional items increased by £10.3 million (12%) from £87.9 million in 2001 to £98.2 million in 2002.

The increase in operating profit arose principally in the United States market as a result of sales growth, offset partly by further investment in the development of image guided surgery products and the OXINIUM range of knee and hip components and increased insurance costs.

Operating profits also increased in Australia/New Zealand and Japan as a result of increased sales. However, operating losses were incurred in France and profits were lower than prior year in Germany and Italy due to investment in selling and marketing resources and the adverse effect of transactional currency. An operating loss was also incurred in Canada due to the effect of cost dis-synergies arising from the divestment of the rehabilitation and ear, nose and throat businesses.

Endoscopy

Sales

Sales in the endoscopy business increased by £39.0 million (15%) from £252.8 million in 2001 to £291.8 million in 2002. The acquisition of ORATEC contributed 9% points of this growth, the negative effect of currency translation into sterling was 4% points and underlying sales grew by 10% points.

Sales in the United States grew by 21%, of which the acquisition of ORATEC arthroscopy products contributed 9% points and ORATEC spine products 5% points, and underlying sales growth contributed 7% points. The principal reason for the underlying sales growth was the introduction of a number of new products, particularly TRIVEX, FAST-FIX and BIO-RCI. The ORATEC acquisition did not impact sales growth outside the United States.

Sales in the United Kingdom/Ireland, the endoscopy business's second largest market by sales value, increased by 13% due to new products and gains in market share. Sales in France and Italy grew in excess of 20%, principally due to new products in the Repair sector. Sales in Japan grew by 16% and in Australia/New Zealand by 21% as a result of increased sales force strength. Sales in Canada declined due to government healthcare funding constraints.

On a product segment basis, Resection sales grew by 28% as a result of the ORATEC acquisition, Repair sales grew by 21% largely as a result of new products and sales of Visualization, Access and Service increased by 6%.

Operating profit

Operating profit from the endoscopy business before goodwill amortization and exceptional items increased by £7.0 million (15%) from £46.8 million in 2001 to £53.8 million in 2002.

Operating profits rose in the United States market due to the increase in sales and the benefit of the ORATEC acquisition, which contributed operating profits of £3.8 million in 2002.

Operating profits in the United Kingdom/Ireland, Italy, Australia/New Zealand and France increased as a result of sales growth more than offsetting adverse transactional currency movements. Operating profits in Japan increased by less than the growth in sales due to adverse currency movements and investment in additional selling and marketing resources.

Canada incurred a loss compared with a small profit in 2001 due to a decline in sales.

Advanced wound management

Sales

Sales in the advanced wound management business increased by £36.1 million (13%) from £285.6 million in 2001 to £321.7 million in 2002. The acquisitions made in 2001 contributed 4%, the negative effect of currency translation into sterling was 2% points and underlying sales grew by 11%.

Sales in the United States grew by 11%, of which 4% points was due to the full year effect of the ACTICOAT silver dressing acquired in May 2001. Sales of tissue-engineered wound dressings more than doubled to £6.1 million following the launch of DERMAGRAFT, in the United States, in April 2002.

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Sales in the United Kingdom/Ireland grew by 10% due to market share gains and the effect of a full year of sales of products acquired from Beiersdorf AG in April 2001.

Additional investment in sales force led to sales increases of 35% in Japan and 28% in France. Sales in Germany grew by 31% over the prior year largely due to the impact of the acquisitions referred to above. Sales in Canada were flat compared to the prior year due to government funding constraints.

Of the principal products, sales of the ALLEVYN adhesive hydrocellular dressing increased by 21% and sales of ACTICOAT increased by 59%, while sales of collagenase wound bed preparation products declined by 9% in the United States due to supply problems but increased by 3% outside of the United States.

Operating profit

Operating profit from the advanced wound management business before goodwill amortization and exceptional items increased by £7.9 million (22%) from £36.1 million in 2001 to £44.0 million in 2002.

Losses arising from the DERMAGRAFT joint arrangement increased from £7.0 million in 2001 to £8.0 million in 2002 as a result of additional sales force expense following the launch of DERMAGRAFT in the United States in April 2002 and the consolidation of 100% of losses from November 25, 2002 following the acquisition of the remainder of the ATS arrangements.

Operating profits in the United Kingdom/Ireland and the United States increased by 20% and 17%, respectively, due to additional sales volumes.

Operating profits in Japan increased strongly as a result of higher sales which more than offset the effect of reimbursement price reductions in certain products. France increased its loss with margin on higher sales being insufficient to offset increased sales force investment and dis-synergies arising from the separation of the business from BSN Medical. Germany profits increased as a result of the acquisitions in 2001.

Discontinued Operations

Sales of £26.2 million from discontinued operations in 2002 comprise three months of sales of the rehabilitation business. Profit thereon was £2.1 million.

Interest Income and Expense

Interest income increased by £4.1 million from £2.5 million in 2001 to £6.6 million in 2002. Interest expense decreased by £2.2 million from £19.0 million in 2001 to £16.8 million in 2002. The Group's share of the joint venture's and associated undertaking's net interest expense was £1.6 million and £0.9 million, respectively. Interest payable on currency swaps amounting to £23.3 million has been set off against interest receivable on swaps. Net interest expense decreased by £4.7 million to £12.7 million due to falling US Dollar and Euro interest rates on interest expense offset by falling Sterling rates on interest income.

Fiscal 2001 compared with fiscal 2000

Group sales during fiscal 2001 amounted to £1,081.7 million, a decline of 5% when compared to fiscal 2000. After excluding sales of operations contributed to the joint venture and of discontinued operations, sales growth of ongoing operations was 22%. Of this, 14% was underlying sales growth, 6% was from businesses acquired in 2001 and 2000 and 2% from currency translation. Selling price increases accounted for approximately 1% point of sales growth.

Operating profit of ongoing operations before goodwill amortization and exceptional items was £170.8 million in 2001, a 21% increase over 2000, with operating margin declining from 18.2% in 2000 to 18.1%. Efficiency improvements were in excess of 1% of sales but were offset by divestment dis-synergies and adverse transactional currency.

Sales of operations contributed to the joint venture of £35.3 million in 2001 relate to the three months of sales operations of the casting and bandaging and traditional woundcare businesses and compares with £138.6 million in 2000 which reflects a full year's trading. Operating profit thereon was £3.6 million and exceptional costs of £1.8 million were incurred that represent manufacturing rationalization costs of operations subsequently contributed to BSN Medical.

Sales of £103.4 million from discontinued operations in 2001 comprise a full year of sales operations of the rehabilitation business and five months of sales operations of the ear, nose and throat business. Profit thereon was £11.1 million. Sales and operating profits were £223.2 million and £29.0 million respectively in 2000, which reflects a full year of sales operations of the rehabilitation and ear, nose and throat businesses and six months of trading of the consumer healthcare business. Exceptional items of £3.9 million were incurred in 2000 that represent manufacturing rationalization costs.

Group share of joint venture sales for nine months was £123.6 million and of operating profit before exceptional items was £12.8 million. The Group's share of rationalization costs of BSN Medical was £5.0 million.

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Goodwill amortization increased by £3.5 million compared with 2000 principally due to the ACTICOAT and advanced woundcare acquisitions and a full year of collagenase.

The principal exceptional item in 2001 was a £49.2 million net gain on the disposal of the ear, nose and throat business. Operating exceptional items within ongoing operations of £19.3 million comprise £2.9 million on the manufacturing rationalization program, £7.5 million on the rationalization consequent on the contribution of businesses to BSN Medical and £8.9 million on integration in connection with the advanced woundcare business acquired from Beiersdorf AG.

Profit before taxation, goodwill amortization and exceptional items amounted to £180.9 million, £2.0 million higher than 2000, because of improved operating profits offset by the loss of profits from the disposal of the consumer business in 2000, the full year effect of financing the payment of the special dividend in 2000 and divestment dis-synergies.

Profit before taxation was £193.6 million, compared with £265.2 million in 2000, which included a gain on the disposal of the consumer healthcare business of £109.5 million.

The underlying tax charge of £52.3 million represents 29% of profit before goodwill amortization and exceptional items, a decrease of 1% when compared with fiscal 2000. The tax charge on net exceptional items was £11.7 million.

Basic earnings per share were 14.07p, a decrease of 30% over 2000. Adjusted earnings per share before goodwill amortization and exceptional items were 13.96p, an increase over 2000 of 15%. Adjusting for the loss of profits caused by the disposal of the consumer healthcare business in 2000 and the ear, nose and throat business and the formation of BSN Medical joint venture in 2001, earnings per share before exceptional items rose 16% over 2000.

Management is not aware of any governmental, economic, fiscal, monetary or political policies or factors that have materially affected, directly or indirectly, the Group's operations or investments by shareholders.

Orthopaedics

Sales

Sales in the orthopaedics business increased by £69.6 million (21%) from £335.0 million in 2000 to £404.6 million in 2001. After adjusting for acquisitions and the effect of currency translation into sterling, sales grew by 18% in underlying terms.

Sales of orthopaedic products in the United States grew 22%, as a result of the performance of the new hip joint replacement products introduced in 2000, sustained growth in both existing and new knee implants and the launch of new trauma products particularly the TRIGEN nailing system. The new OXINIUM knee contributed four percentage points of sales growth.

Orthopaedics sales in the United Kingdom grew 26%, reflecting sustained growth from trauma products and the impact of new hip joint products. Sales in Germany, France and Italy grew by 10%, 11% and 9%, respectively, largely due to market share gains in knee implants.

Underlying sales growths of orthopaedic products were 3% in Japan mainly in trauma products and 31% in Australia/New Zealand following the launch of new products and the appointment of a new sales agent in New South Wales.

Operating profit

Operating profit from the orthopaedics business before goodwill amortization and exceptional items increased by £18.8 million (27%) from £69.1 million in 2000 to £87.9 million in 2001.

The profit increase occurred principally in the United States as a result of additional sales. Operating results were lower than in the prior year in both Germany and France as a result of continuing high levels of investment in selling resources. In Japan, profits increased 4%, in line with the sales increase. Profits in Australia/New Zealand increased substantially due to higher sales.

Endoscopy

Sales

Sales in the endoscopy business increased by £36.4 million (17%) from £216.4 million in 2000 to £252.8 million in 2001. After adjusting for acquisitions and the effect of currency translation into sterling, sales in the market grew by 11% in underlying terms.

Sales of endoscopy products in the United States grew 7% before acquisitions, with shavers and blades sustaining growth and joint repair products increasing sales by 11% due to the introduction of new products and market share gains. The Orthopaedic Biosystems business acquired in 2000 contributed £6 million (equivalent to 4% points of growth) in 2001.

Sales of endoscopy products grew 34% in the United Kingdom/Ireland with growth across all segments of the product range, but particularly in repair and resection. Market share gains in the repair segment produced sales increases of 15%, 17% and 10%, respectively, in Germany, France and Italy. There was 18% growth in Australia/New Zealand as a result of stronger sales in shaver and blade products and the benefit from a new sales agent in New South Wales. Repair products in Japan gained further market share resulting in sales growth of 28%.

Operating profit

Operating profit from the endoscopy business before goodwill amortization and exceptional items increased by £8.6 million (23%) from £38.2 million in 2000 to £46.8 million in 2001.

Operating profits increased by more than the rate of sales growth due to the synergy benefits of the Orthopaedic Biosystems acquisition and cost savings achieved in manufacturing. Significant profit increases were achieved in the United Kingdom and Japan arising from leverage benefits of additional sales.

Advanced wound management

Sales

Sales in the advanced wound management business increased by £64.1 million (29%) from £221.5 million in 2000 to £285.6 million in 2001. After adjusting for acquisitions and the effect of currency translation into sterling, sales grew by 11% in underlying terms.

Underlying sales growth of advanced wound management products in the United States was 9%. The acquisition of the advanced woundcare business from Beiersdorf AG in April 2001 contributed a further 4% points of sales growth and the ACTICOAT dressing, acquired in May 2001, contributed a further 5% points of sales growth. Sales of collagenase, acquired in 2000, grew by 13%.

Advanced wound management product sales grew 8% in the United Kingdom/Ireland due primarily to sales growth in hydrocellular dressing products. Sales in Germany more than doubled as a result of the advanced woundcare acquisition and sales in Italy more than doubled due to the collagenase acquisition by the Group in 2000.

Advanced wound management sales grew 34% in Australia/New Zealand, of which 12% was underlying growth led by the hydrocellular dressings product range and 22% was from sales resulting from the acquisition of the advanced wound management business in April 2001.

Operating profit

Operating profit from the advanced wound management business before goodwill amortization and exceptional items increased by £2.7 million (8%) from £33.4 million in 2000 to £36.1 million in 2001.

The profit increase was below the rate of sales growth due to the impact of residual costs remaining after separating and contributing to BSN Medical the casting and bandaging and traditional woundcare product lines which in most countries were sold and distributed by the advanced wound management business. These dis-synergies were offset partly by the benefits of profits and recoveries arising from acquisitions.

The DERMAGRAFT development program involved revenue investment of £7.0 million in 2000 the revenue investment was £6.0 million.

Operations Contributed to the Joint Venture

Group turnover and operating profit include the results of the casting and bandaging and traditional woundcare businesses up to the date of transfer on April 1, 2001, to BSN Medical. These are captioned Operations Contributed to the Joint Venture. Sales of £35.3 million in 2001 relate to the three months of sales operations of the casting and bandaging and traditional woundcare businesses. Profit thereon was £3.6 million before £1.8 million of exceptional manufacturing rationalization costs.

Discontinued Operations

Sales of £103.4 million from discontinued operations in 2001 comprise a full year of sales operations of the rehabilitation business and five months of sales operations of the ear, nose and throat business. Profit thereon was £11.1 million.

Interest Income and Expense

Interest income decreased by £1.9 million from £4.4 million in 2000 to £2.5 million in 2001. Interest expense increased by £7.6 million from £11.4 million in 2000 to £19.0 million in 2001. The Group's share of the joint venture's net interest expense was £0.9 million. Interest payable on currency swaps amounting to £22.2 million has been set off against interest receivable on swaps. Net interest expense therefore increased by £10.4 million to £17.4 million, essentially due to the cost of financing the excess of the special dividend paid in August 2000 over the amounts realized on business disposals in 2000 and 2001.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

The Group's policy is to ensure that it has sufficient funding and facilities in place to meet foreseeable borrowing requirements.

At December 31, 2002, the Group held £22.5 million in cash and balances at bank. The Group had committed and uncommitted bank facilities of £493 million and £255 million, respectively. Unused bank facilities amounted to £432 million, of which £199 million were committed. Of the undrawn committed facilities, £3 million expire within one year and £196 million after two but within five years.

The principal variations in the Group's borrowing requirements result from the timing of the bi-annual dividend payments and acquisitions and disposals of businesses.

The funding of the Group's ongoing capital expenditure and working capital requirements has been financed through cash flow generated by business operations and, where necessary, through short-term committed and uncommitted bank facilities.

Smith & Nephew believes that its capital expenditure needs and its working capital funding for 2003, as well as its other known or expected commitments or liabilities, can be met from its existing resources and facilities.

The falls in the stock market values of the last three years have adversely affected the funding levels of both major defined benefit pension plans. Existing pension provisions and planned contribution increases in the future are considered adequate to cover the current under funding position.

In the three year period ended December 31, 2002, £326.7 million was spent on acquisitions:

	(£ million)
2000:	
Collagenase	30.9
Orthopaedic Biosystems	17.3
Other	2.9
	51.1
2001:	
Advanced Woundcare	30.0
Acticoat	11.7
Deferred consideration paid for collagenase	20.0
Other	7.6

	69.3
2002:	
Oratec (net of cash acquired)	191.2
Dermagraft	7.8
Deferred consideration paid for collagenase	5.5
Other	1.8
	206.3
	326.7

In the three year period ended December 31, 2002, £343.3 million was raised from the sale of businesses. This comprised £209.8 million from the sale of the consumer healthcare business in June 2000, £61.7 million from the sale of the ear, nose and throat business in June 2001 and £71.8 million, from the sale of the rehabilitation business in March 2002.

On March 20, 2003, the Company and Smith & Nephew Group entered into a new credit agreement (the "Credit Agreement") with Lloyds TSB Capital Markets and The Royal Bank of Scotland plc as arrangers, the financial institutions listed therein as original lenders (the "Original Lenders") and The Royal Bank of Scotland as facility agent. Pursuant to the Credit Agreement, the Original Lenders have agreed to make available multi-currency term loan facilities in an aggregate principal amount of US\$2.1 billion to finance the acquisition of Centerpulse and InCentive, to refinance existing debt (including the debt of Centerpulse) and for general corporate purposes, including working capital requirements. It is a requirement of the Credit Agreement that the Company's existing facilities of £250,000,000 and US\$225,000,000 dated June 28, 2000 and US\$300,000,000 dated February 14, 2002 are repaid in full and cancelled. The facility will be guaranteed by Smith & Nephew Group, Smith & Nephew plc, Smith & Nephew, Inc., T.J. Smith & Nephew Limited and Smith & Nephew JV (Holdings) GmbH.

Operating cash flow before outgoings on rationalization, divestment and acquisition integration was £142.5 million, a 72% conversion of operating profit before goodwill amortization and exceptional items. Net cash flow and movement in net borrowings during 2002 were:

	(£ million)
Operating cash flow	142.5
Rationalization, divestment and integration	(19.3)
Joint venture	9.6
Interest, tax and dividends	(106.0)
Disposals	71.8
Acquisitions	(206.3)
Issues of share capital	6.1
	<hr/>
Net cash flow	(101.6)
Exchange adjustments	68.2
Opening net borrowings	(243.5)
	<hr/>
Closing net borrowings	(276.9)
	<hr/>

The Group's net borrowings increased by £299.2 million from net cash of £22.3 million at the beginning of 2000 to £276.9 million at the end of 2002. Translation of foreign currency net borrowings into sterling has decreased net borrowings by £29.5 million in the three year period ended December 31, 2002.

Further information regarding borrowings at December 31, 2002 is set out in Note 19 of the Notes to the Financial Statements. The Group complies with all of its borrowing covenants. The Group believes that none of these covenants represents a restriction on funding or investment policy for the foreseeable future.

At December 31, 2002, £4.3 million of capital expenditure had been contracted for. The purposes of the capital expenditure are the replacement of old equipment and the acquisition of additional new buildings and equipment.

EXCHANGE AND INTEREST RATE RISK, AND FINANCIAL INSTRUMENTS

The Board of Directors of the Company has established a set of policies to manage funding, currency and interest rate risks. The Group only uses derivative financial instruments to manage the financial risks associated with underlying business activities and their financing.

Interest Rate Risk

The Group uses simple floating to fixed rate contract interest rate swaps to meet its objective of protecting borrowing costs and differentials between borrowing and deposit rates within parameters set by the Board. Interest rate swaps are accounted for as hedges, as such changes in fair values resulting from changes to market rates are not recognized in the Group balance sheet and do not affect reported profits. The cash flow

effects of interest rate swaps match cash flows on the underlying instruments such that there is no net cash flow effect from movements in market interest rates.

If the Group had not transacted interest rate swaps to hedge its interest rate risk, based upon the net debt position at December 31, 2002, an increase in short-term interest rates across all currencies by one percentage point would increase the Group's annual net interest payable by £2.7 million. The Group's financial assets and liabilities are principally at floating interest rates and thus their fair values are not directly affected by movements in market rates of interest.

Foreign Exchange Exposure

The Group's policy is to protect shareholders' funds by matching foreign currency assets, including acquisition goodwill, with foreign currency liabilities wherever practicable. These liabilities take the form of either borrowings or currency swaps.

Foreign exchange variations affect trading results in two ways. First on translation of overseas sales and profits into sterling and secondly, the currency cost of purchases by Group companies of finished products and raw materials. The principal flows of currency are purchases of US dollars and UK sterling from euros, Japanese yen and Canadian and Australian dollars, as well as cross purchases between the United States and the United Kingdom.

The Group partly mitigates the translational impact on profits through the interest arising on foreign currency borrowings or swaps. The impact of currency movements on the cost of purchases is partly mitigated by the use of forward foreign exchange contracts.

Had the Group not transacted forward foreign exchange contracts to hedge transactional exposure and if sterling were to have weakened on average over the year by 10% against all other currencies, Smith & Nephew's profit before taxation in 2002 would have increased by £23 million. If the US dollar were to have weakened on average over the year by 10% against all other currencies, profit before taxation in 2002 would not have changed materially.

Financial Instruments

The Group's financial instruments are subject to changes in fair values as reported in the Group balance sheet as a result of changes in market rates of exchange. All financial instruments denominated in currencies other than sterling hedge foreign currency assets. As a result, changes in fair values of financial instruments do not affect the Group's profit before taxation.

The Group limits exposure to credit risk on counterparties used for financial instruments through a system of internal credit limits which, with certain minor exceptions due to local market conditions, require counterparties to have a minimum A rating from the major ratings agencies. The financial exposure of a counterparty is determined as the total of cash and deposits, plus the risk on derivative instruments, assessed as the fair value of the instrument plus a risk element based on the nominal value and the historic volatility of the market value of the instrument. Smith & Nephew does not anticipate non-performance of counterparties and believes it is not subject to material concentration of credit risk.

Group borrowings take advantage of short-term interest rates. The Group uses interest rate swaps to protect borrowing costs and the differentials between borrowing and deposit rates.

At December 31, 2002, the Group held sterling interest bearing assets of £581 million on which interest has been fixed on £503 million at 5.1% for 2003 and £103 million at 4.8% for 2004, a weighted average of 5.1% for a weighted average period of one year. The remainder of its sterling interest bearing assets were cash balances held on short-term deposits at floating rates. The Group also held £22 million of foreign currency interest bearing assets as cash or on short-term deposit at floating rates.

The Group's interest bearing liabilities at December 31, 2002 included £657 million of US dollars and £137 million of euros on which interest has been fixed for one year on £563 million of US dollars and £100 million of euros at weighted average rates of 3.8% and 3.4%, respectively. Interest has also been fixed on £112 million of US Dollars for 2004 at 3.0% and on £26 million of euros for 2004 at 4.5%. The remaining interest bearing liabilities totalled £85 million of various currencies and are at floating rates.

Foreign Exchange Transaction Exposure

The Group trades in over 90 countries and as a consequence manages £270 million of foreign currency transactions by using forward foreign exchange contracts, of which the major transaction flow is euros into US dollars. The Group's policy is for firm commitments to be fully covered and forecasts to be covered between 50% and 90% for up to one year, and for operating units not to hold unhedged monetary assets or liabilities

other than in their functional operating currencies.

RESEARCH AND DEVELOPMENT; INTELLECTUAL PROPERTY

Research and Development

The Group's R&D is directed towards orthopaedics, endoscopy and advanced wound management. The Group's expenditures on R&D amounted to £61 million in 2002 (2001 £51 million, 2000 £46 million), representing 5.5% of sales revenues.

The Group's principal research facility is located in York, England. The Group's research program seeks to underpin the longer term technology requirements for its businesses and to provide a flow of innovative product concepts.

Product development programs are carried out at the Group's principal manufacturing locations, notably in Memphis, Tennessee (orthopaedics), Andover and Mansfield, Massachusetts (endoscopy) and Hull, England

and La Jolla, California (advanced wound management). In-house research is supplemented by work performed by academic institutions and other external research organizations principally in the United Kingdom and the United States.

Intellectual Property

Management believes that the Group's active policy concerning intellectual property rights promotes innovation in its businesses. Smith & Nephew has a policy of protecting, with patents, the results of the R&D carried out throughout the Group. Patents have been obtained for a wide range of products, including those in the fields of advanced wound management, orthopedic and endoscopic technologies. Patent protection for Group products is routinely sought in the Group's principal markets. Currently, the Group's patent portfolio stands at over 2,450 existing patents and patent applications.

Smith & Nephew also has a policy of protecting the Group's products in the markets in which they are sold by registering trade marks as soon as possible under local laws. The Group vigorously protects its trade marks against infringement and currently is not aware of any significant infringement of its trade mark registrations. The present trade mark portfolio of the Group consists of over 4,200 trade marks and design rights.

In addition to maintaining a policy of protecting its market position by the filing and enforcement of patents and trademarks, Smith & Nephew has a policy of opposing third party patents and trademarks in those areas that might conflict with the Group's business interests.

In the ordinary course of its business, the Group enters into a number of licensing arrangements with respect to its products. None of these arrangements individually is considered material to the operations and the financial results of the Group.

TREND INFORMATION

Additional sales of approximately £10 million are expected to arise from the effect of the ownership of ORATEC for 12 months in 2003 compared with 9 months in 2002.

The effect in 2003, of the divestiture of the rehabilitation business will be a reduction in sales of £26 million and a reduction in operating profit of £2 million when compared with 2002.

The effect of the acquisition of DERMAGRAFT in November 2002, will be to consolidate 100% of operating profits/losses in 2003 compared with 50% of losses for 11 months and 100% of losses for one month in 2002.

A significant external influence on Group sales and profits in 2003 will be the translational effects of currency to the extent that rates of exchange differ from those in year 2002.

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A further influence on profit and margin trends in 2003 will be the transactional effects of currency to the extent that rates of exchange differ from those in 2002.

The falls in stock market values of the last three years have adversely affected the funding levels of the Group's major defined benefit pension plans giving rise to combined net deficits estimated at £80 million. The deficit is to be funded over future working lives which will adversely impact pension expense and operating cash flow over that period.

As described above under Item 4 Information on the Company History and Development of the Company Recent Developments, on March 20, 2003, the Company and Smith & Nephew Group entered into the Combination Agreement and the InCentive Agreement in connection with the planned acquisition of all the outstanding shares of Centerpulse. For the year ended December 31, 2002, Centerpulse reported sales of CHF 1,241 million and operating profit before goodwill amortization and exceptional items of CHF 228 million for continuing operations.

Completion of the planned transaction will result in Smith & Nephew Group being the global number three, by market share, in the orthopaedics sector. Management believes that completion of the transaction will bring together complementary geographic fit and product ranges and develop more rapidly the technological capabilities of the two businesses.

Management believes that completion of the transaction will generate significant long-term value through the combined product base of both companies, customer network and scale-related benefits.

ITEM 6 DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES**DIRECTORS AND SENIOR MANAGEMENT**

The Board of Directors of Smith & Nephew is responsible for the strategic direction, policies and overall management of the Group. The Board of Smith & Nephew currently comprises nine Directors of whom two are Executive Directors and seven of whom are independent Non-Executive Directors. There is provision for a quorum of not fewer than two in number.

The Board of Directors of Smith & Nephew as at April 7, 2003 comprised:

	Position	Initially elected or appointed	Date of next reappointment
Dudley G. Eustace	Non-Executive Chairman	November 10, 1999	2003
Christopher J. O'Donnell	Executive Director, Chief Executive	September 1, 1992	2004
Peter Hooley	Executive Director (responsible for Finance and Information Technology)	April 2, 1991	2003
Sir Timothy Lankester	Non-Executive Director	June 1, 1996	
Dr. Rolf W. H. Stomberg	Non-Executive Director	January 1, 1998	2004
Warren D. Knowlton	Non-Executive Director	November 1, 2000	2004
Richard De Schutter	Non-Executive Director	January 1, 2001	2004
Brian Larcombe	Non-Executive Director	March 1, 2002	2005
Dr. Pamela J. Kirby	Non-Executive Director	March 1, 2002	2005

The Chief Executive of Smith & Nephew and other senior executives are responsible for the day-to-day management of the Group. The Group's Executive Committee (GEC), which comprises the Executive Directors and certain other senior executives of Smith & Nephew (the Executive Officers), assists the Chief Executive in the management of the business. The following are Executive Officers of Smith & Nephew and all, apart from the Company Secretary, are members of the GEC:

	Position	Date of appointment
James L. Dick	President, Advanced Wound Management	January 1, 1999
Peter W. Huntley	Group Director, Strategy and Business Development	April 1, 1998
David Illingworth	President, Orthopaedics	May 1, 2002
James A. Ralston	Chief Legal Officer	February 1, 2002
Ronald M. Sparks	President, Endoscopy	January 1, 1999
Dr. Alan Suggett	Group Director, Technology	January 1, 1986
James Taylor	Group Director, Indirect Markets	June 1, 2000
Paul M. Williams	Group Director, Human Resources	December 1, 1998
Paul R. Chambers	Company Secretary	April 8, 2002

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Under Smith & Nephew's Articles of Association, any Director who has been appointed by the Board of Directors since the previous Annual General Meeting of shareholders, either to fill a casual vacancy or as an additional Director, holds office only until the next Annual General Meeting and then shall be eligible for election by the shareholders. The other Directors shall retire and be eligible for re-appointment at the third annual general meeting after the meeting at which they were last re-appointed. The Directors are subject to removal with or without cause by the Board of Directors or the shareholders. Executive Officers serve at the discretion of the Board of Directors.

All directors are subject to re-election every three years and, in accordance with the Articles of Association, Dudley Eustace and Peter Hooley retire by rotation and, being eligible offer themselves for re-election at the Annual General Meeting to be held on April 29, 2003. Sir Timothy Lankester will be retiring at the Annual General Meeting but will not be offering himself for re-election.

None of the Directors or Executive Officers has a family relationship with any other Director or Executive Officer.

Ages of and Appointments held by Directors and Executive Officers

Directors

Dudley G. Eustace, Chairman, age 66, was appointed Deputy Chairman in 1999 and Chairman in January 2000. Chairman of the Nominations Committee. He is the non-executive Chairman of Sendo Holdings plc and a non-executive director of KLM Royal Dutch Airlines NV, Aegon NV, Hagenmeyer NV, Royal KPN NV and Sonae.Com SGPS.

Christopher J. O'Donnell, Chief Executive, age 56. He joined the Group in 1988 and was appointed a director in 1992. He was appointed Chief Executive in 1997. He is a non-executive director of BOC Group Plc.

Peter Hooley, Finance Director, age 56, joined the Group and was appointed a director in 1991. He is a non-executive director of Cobham plc.

Dr. Pamela J. Kirby, age 49, appointed a director in March 2002. She is Chief Executive Officer of Quintiles Transnational Corporation.

Warren D. Knowlton, age 56, appointed a director in November 2000. Chairman of the Audit Committee. He is Group Chief Executive of Morgan Crucible Plc.

Sir Timothy Lankester, age 60, a director since June 1996. He is president of Corpus Christi College, Oxford. He is also an independent director of the London Metal Exchange and Deputy Chairman of the British Council.

Brian Larcombe, age 49, appointed a director in March 2002. He is Chief Executive of 3i Group plc.

Richard De Schutter, age 62, appointed a director in January 2001. He is a non-executive director of General Binding Corporation, ING Americas, Varian Inc, Incyte Genomics and Med/Pointe Pharmaceuticals.

Dr. Rolf W. H. Stomberg, age 62, a director since 1998. He is senior independent director and Chairman of the Remuneration Committee. He is Chairman of Management Consulting Group plc and a non-executive director of Scania AB, Stinnes AG, Reed Elsevier plc, Cordiant Communications plc, TPG Group Plc, Hoyer GmbH and Deutsche BP AG.

Executive Officers

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James L. Dick, age 50, President Advanced Wound Management. He joined the Group in 1977 and was appointed to the GEC in 1999.

Peter W. Huntley, age 42, Group Director Strategy and Business Development. He joined the Group and was appointed to the GEC in 1998.

David Illingworth, age 49, President Orthopaedics. He joined the Group and was appointed to the GEC in 2002.

James A. Ralston, age 56, Chief Legal Officer. He joined the Group in 1999 and was appointed to the GEC in 2002.

James Taylor, age 46, Group Director Indirect Markets. He joined the Group and was appointed to the GEC in 2000.

Ronald M. Sparks, age 47, President Endoscopy. He joined the Group in 1983 and was appointed to the GEC in 1999.

Dr. Alan Suggett, age 59, Group Director of Technology. He joined the Group in 1982 and was appointed to the GEC in 1986.

Paul M. Williams, age 56, Group Director Human Resources. He joined the Group and was appointed to the GEC in 1998.

Company Secretary

Paul R. Chambers, age 58. He joined the Group in 1994 and was appointed Company Secretary in 2002.

COMPENSATION

Directors Emoluments and Pensions

	Salaries and fees	Benefits	Bonus	Total emoluments excluding pension entitlements	Pension entitlements	Total including pension entitlements 2002	Total excluding pension entitlements 2001	Total including pension entitlements 2001
(£ thousands)								
Chairman (non-executive):								
Dudley G. Eustace	170			170		170	170	170
Executive Directors:								
Christopher J. O'Donnell	472	22	362	856	34	890	770	790
Peter Hooley	280	19	212	511	72	583	484	545
Non-executive Directors:								
Sir Timothy Lankester	30			30		30	30	30
Dr. Rolf W. H. Stomberg	30			30		30	30	30
Warren D. Knowlton	30			30		30	30	30
Richard De Schutter	30			30		30	30	30
Dr. Pamela J. Kirby (from March 1, 2002)	25			25		25		
Brian Larcombe (from March 1, 2002)	25			25		25		
Sir Anthony Cleaver (to Feb. 28, 2002)	5			5		5	30	30
Sir Brian Pearse (to Feb. 28, 2002)	5			5		5	30	30
	<u>1,102</u>	<u>41</u>	<u>574</u>	<u>1,717</u>	<u>106</u>	<u>1,823</u>	<u>1,604</u>	<u>1,685</u>

Dudley G. Eustace's annual fee of £170,000 includes a non-executive director's fee of £30,000. For Christopher J. O'Donnell, 58% of total remuneration excluding pension entitlement was base salary and benefits and 42% related to Company performance. For Peter Hooley, 59% was base salary and benefits and 41% related to Company performance.

Directors Share Options

Options Jan 1, 2002	Granted (during the year)	Exercised	Exercise price	Market price at date of exercise	Profit on exercise	Options Dec 31, 2002	Average exercise price	Range of exercisable dates of options
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							held at		
							Dec 31, 2002		
	(Number)	(Number)	(Number)	(p)	(p)	(£)	(Number)	(p)	(Date)
Christopher J. O'Donnell	170,000(1)						170,000	187.0	8/97 - 9/06
	(2)	3,192*					3,192	296.0	11/05 - 4/06
	161,263(3)	183,040					344,303		2/01 - 4/09
	<u>331,263</u>	<u>186,232</u>					<u>517,495</u>		<u>8/1997 - 4/2009</u>
Peter Hooley	317,500(1)		90,000	168.0	403.5	211,950	227,500	158.0	8/96 - 9/06
	3,349(2)						3,349	289.0	11/04 - 4/05
	102,874(3)	116,959					219,833		2/01 - 4/09
	<u>423,723</u>	<u>116,959</u>	<u>90,000</u>	<u>168.0</u>	<u>403.5</u>	<u>211,950</u>	<u>450,682</u>		<u>8/1996 - 4/2009</u>

- * options granted on Sept 25, 2002 at 296p
(1) Options granted under Executive Share Option Plans.
(2) Sharesave options.
(3) Nil-cost options acquired through the vesting of LTIP awards.

The range in the market price of the Company's Ordinary Shares during the year was 305p to 430p and the market price at December 31, 2002 was 380.5p. Exercise prices of outstanding options at December 31, 2002 were below 380.5p. The total profit on exercise of options during the year was £211,950 as set out above (2001 £197,542: Christopher J. O'Donnell £22,171, Peter Hooley £175,371).

Directors Interests

Beneficial interests of the Directors in the Ordinary Shares of the Company are as follows:

	December 31, 2002		January 1, 2002	
	Shares	Options	Shares	Options
	(Number)			
Dudley G. Eustace	49,679		40,909	
Christopher J. O Donnell	122,136	517,495	120,703	331,263
Peter Hooley	111,571	450,682	58,789	423,723
Sir Timothy Lankester	6,096		6,035	
Brian Larcombe				
Dr. Pamela J. Kirby				
Dr. Rolf W. H. Stomberg	6,945		6,864	
Warren D. Knowlton	12,501		7,501	
Richard De Schutter	200,000		100,000	

On February 7, 2003, Christopher J. O Donnell became entitled to 155,065 Ordinary Shares and Peter Hooley 96,916 Ordinary Shares in respect of the 100% vesting of the 2000 long-term incentive plan. On April 4, 2003 these Shares were acquired in the form of nil-cost share options. There were no other changes in the interests of Directors between December 31, 2002 and April 7, 2003.

The register of directors interests, which is open to inspection at the Company's registered office, contains full details of Directors' shareholdings and share options.

Remuneration Policy

The Remuneration Committee policy for this and future years is to ensure that remuneration is sufficiently competitive to attract, retain and motivate Executive Directors and GEC members of a caliber that meets the Group's needs to achieve its performance against financial objectives and relevant competitors' practice. Remuneration throughout the Group is designed to be competitive in the country of employment.

The principal components of remuneration, which will remain in operation for the next financial year and thereafter, for Executive Directors and the GEC members are: basic salary and benefits, performance related bonus, long term incentives and pensions.

Basic Salary and Benefits

Basic salary reflects the responsibility of the job and individual performance. The Company also provides private healthcare coverage and a company car or allowance.

Performance-Related Bonus

For Executive Directors, the Company operates an annual bonus scheme, 75% of which is based on annual growth in adjusted basic earnings per share after deducting goodwill amortization and 25% of which is based on return on operating capital employed. The scheme is designed to encourage performance which the Remuneration Committee considers would contribute most to increasing shareholder value. Achievement of targets should produce a bonus of 30% of annual salary with a maximum of 100% for over achievement that demonstrates a step change in Group performance. Bonuses are not pensionable.

For members of the GEC with corporate responsibilities, the annual bonus plan is linked to earnings per share, return on capital employed and personal objectives. For those members with specific business unit responsibilities, targets are linked to earnings per share, sales, profit and return on capital employed of their respective business unit.

Long-term incentives

The Company operates a long-term incentive plan (LTIP) for Executive Directors and members of the GEC to motivate and reward these key executives to significantly enhance the value of the Company. Under this shares are transferred to participants depending on the Company's performance in relation to a group of 41 UK listed manufacturing companies with substantial international activities, using total shareholder return (TSR) over a three-year period as the prime measure. The performance conditions were identified as those which represented a fair measure of the Company's performance and would reflect increase in shareholder value. The maximum value of shares awarded for Executive Directors will not exceed the participants' current annual rate of basic salary at the

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date the award is granted, and for members of the GEC it will not exceed 75% of their current rate of basic salary. Shares will only be transferred to the participants if the Company's TSR performance is at or above the median performance of the comparator companies, and growth in the Company's adjusted earnings per share after deducting goodwill amortization exceeds growth in the United Kingdom Retail Price Index (RPI) in the same three-year period. At the median level, 25% of the award shares will vest. If the Company's performance is in the top quartile, all the shares will vest. For performance between the median and the top quartile, the proportion of shares vesting will vary on a straight-line basis. The Company's TSR performance and its performance relative to the comparator group is independently monitored by Monks Partnership (PwC).

The comparator group comprises the following companies:

Aga Foodservice Group	Coats	Johnson Matthey	Rolls-Royce
AstraZeneca Group	Cookson Group	Laird Group	Scapa Group
BAE Systems	Croda International	Low & Bonar	Spirax-Sarco Engineering
Balfour Beatty	De La Rue	Marconi	Spirent
BBA Group	Delta	Morgan Crucible Company	Tate & Lyle
BOC Group	Elementis	Novar	Tomkins
BPB Industries	FKI	Pilkington	TT Electronics
British Vita	GKN	Reckitt Benckiser	Unilever (UK)
Bunzl	Halma	REXAM	Weir Group
Cadbury Schweppes	ICI	RMC Group	
Charter	IMI		

The maximum number of shares to be allocated to each Executive Director and members of GEC under the LTIP, all for nil consideration, are:

	Maximum number of shares awarded at Jan 1, 2002	Awards during the year	Market price	Vested award	Market price at date of award March 8, 1999	Market price at date of vesting	Number of shares awarded at Dec 31, 2002	Latest performance period
	(number)	(number)	(p)	(number)	(p)	(p)	(number)	(p)
Christopher J. O'Donnell	448,649	120,879	409.5	183,040	171.0	403.5	386,488	12.31.2004
Peter Hooley	282,965	70,818	409.5	116,959	171.0	403.5	236,824	12.31.2004
Peter W. Huntley	143,529	32,051	409.5	60,526	171.0	403.5	115,054	12.31.2004
Dr. Alan Suggett	122,927	27,197	409.5	50,438	171.0	403.5	99,686	12.31.2004
James L. Dick	83,279	32,051	409.5				115,330	12.31.2004
Ronald M. Sparks	116,043	45,050	409.5				161,093	12.31.2004
Paul M. Williams	74,702	28,205	409.5				102,907	12.31.2004
James A. Ralston		38,495	409.5				38,495	12.31.2004
James Taylor		31,135	409.5				31,135	12.31.2004

For the three year plan period commencing 2000, the Company's TSR of 147.36% was ranked first in the comparator group and the earnings per share performance criterion was met, enabling the plan participants to be eligible for 100% of the shares conditionally awarded in 2000.

Share options

Executive Directors were last granted options under executive share option schemes in 1996, which were not subject to performance conditions of exercise. The exercise of options granted to members of the GEC between 1997 and 2000 is subject to growth in adjusted basic earnings per share after deducting goodwill amortization of not less than RPI plus 2% per annum in any period of three consecutive years. Since 2001, under the Smith & Nephew 2001 UK Approved Share Option Plan and the Smith & Nephew 2001 UK Unapproved Share Option Plan (UK Plans), the exercise of options is subject to adjusted basic earnings per share growth after deducting goodwill amortization of not less than RPI plus 3% per annum, on average, in a performance period of three consecutive years. In the event the performance target is not met by the end of the third year, the performance period is extended to four years. If it has not been met after four years, the performance period is extended to five years, but if it has still not been met at the end of the fifth year, the options will lapse. Performance conditions were selected to be in line with market practice at the time. Options granted under the Smith & Nephew 2001 US Share Plan (US Plan), in line with market practice, are not subject to performance targets but are exercisable cumulatively up to a maximum of 10% after one year, 30% after two years, 60% after three years and the remaining balance after four years. Since 2002, members of the GEC are not granted share options except on

appointment. Share options are not offered at a discount. UK Executive Directors are eligible to participate in the Smith & Nephew Employee Share Option Scheme.

Pensions

Executive Directors have a normal retirement age of 62 and participate in the defined benefit Smith & Nephew UK Pension Fund and UK Executive Pension Scheme, under which pension has been accrued in the year at an annual rate of one-thirtieth of final pensionable salary, up to a limit of two-thirds of final pensionable salary. Pensions in payment are guaranteed to increase by 5% per annum or inflation, if lower. The Company and the pension plan trustees have in the past granted discretionary increases, particularly at times of high inflation. Death in service cover of four times salary and spouse's pension at the rate of two-thirds of the member's pension are provided on death. A supplementary unfunded defined contribution arrangement partially compensates for the Inland Revenue earnings cap on final pensionable salary.

The US based Executive Officers participate in the defined benefit Smith & Nephew US Pension Plan under which their pensions have accrued at an annual rate of approximately one-sixty second of final pensionable salary, up to a limit, based on service taken into account which has not allowed Executive Officers to accrue a pension of more than 60% of final pensionable salary. The plan also provides for a spouse's pension on death of one-half of the pension that would be received by the Executive Officer under a joint annuity with his or her spouse. Normal retirement age under the plan is 65. A supplementary defined contribution plan was used to compensate for the earnings cap imposed by the US Internal Revenue Code and to provide additional retirement benefits up to one-fiftieth of final pensionable salary and to allow for normal retirement age of 62.

		Increase		Transfer		Increase in	
	Accrued	in accrued	Accrued	value of	Directors	transfer	value over
	pension as	pension	pension at	accrued	contributions	year less	directors
	at Jan 1,	excluding	Dec 31,	pension	during 2002	contributions	Transfer
	2002	inflation	2002	Jan 1, 2002		contributions	value of
		(£ per annum)		(£)	(£)	(£)	accrued
							pension at Dec
							31, 2002
							(£)
Christopher J. O'Donnell	119,000	32,000	153,000	1,521,000	23,000	336,000	1,880,000
Peter Hooley	26,000	2,000	29,000	333,000	4,000	22,000	359,000

An amount of £69,000 was provided for under the supplementary unfunded defined contribution arrangement for Peter Hooley, bringing his total benefit under the plan to £319,000.

Compensation of Executive Officers

The amount of remuneration (excluding pension entitlements) paid by the Group during 2002 to Executive Officers was £3,663,000 (2001 £2,808,000). This figure includes payments under the performance related bonus plan. The increase in accrued pension benefits for Executive Officers was £338,000 (2001 £289,000).

BOARD PRACTICES

Service Contracts

Executive Directors, in line with Group policy, are appointed on contracts terminable by the Company on not more than 12 months' notice. All new appointments are intended to have 12 month notice periods, but it is recognized that for some appointments a longer period may initially be necessary for competitive reasons, reducing to 12 months thereafter. Christopher O'Donnell, appointed to the Board of Directors in September 1992, and Peter Hooley, appointed in April 1991, have contracts terminable by the Company on not more than 12 months notice and by the Executive Director on six months' notice. Termination of the contract by the Company would entitle the Executive Directors to 12 months' basic salary, bonus at target of 30%, a contribution of 30% of salary to reflect the loss of pension benefits, an amount to cover other benefits and a time apportionment of the LTIP entitlement.

Non-Executive Directors do not have service contracts and are normally appointed for terms of three years terminable at will, without notice by either the Company or the director and without compensation. Their remuneration is determined by the Nominations Committee.

Audit Committee

The Audit Committee, chaired by Warren D. Knowlton, consists of independent non-executive directors Sir Timothy Lankester, Brian Larcombe, Richard De Schutter and Dr. Rolf Stomberg.

The Audit Committee monitors the operation and effectiveness of internal financial controls and ensures that the accounts meet statutory and other requirements. It selects, determines the fees and reviews the performance, independence and objectivity of the auditors. Since January 2003, all non-audit work performed by the auditors has been pre-approved by the Committee.

Code of Ethics for Senior Financial Officers

The Board of Directors has adopted a Code of Ethics for its Senior Financial Officers. There have been no waivers to any of the Code's provisions.

Remuneration Committee

The compensation of Executive Directors and members of the GEC is determined by the Remuneration Committee. The Remuneration Committee comprises Dr. Rolf Stomberg (Chairman), Sir Timothy Lankester, Richard De Schutter and Dr. Pamela J. Kirby. Sir Brian Pearse and Sir Anthony Cleaver retired as members of the Committee on February 28, 2002. On behalf of the Board of Directors, it determines the broad policy for executive remuneration. It reviews annually the remuneration, including pension entitlements, for Executive Directors and members of the GEC, and determines the operation of and the participants in the long-term incentive plan, share option schemes and the executive bonus plan. It reviews the relationship between the remuneration of Executive Directors and that of other employees and the competitiveness of executive remuneration, using data from independent consultants on companies of similar size, technologies and international complexity. It also reviews management succession planning. The Committee is assisted by Christopher O'Donnell, the Chief Executive and Paul Williams, the Group HR Director, both of whom have advised on all aspects of the Group's reward structures and policies. In 2002, it received information from Watson Wyatt on a broad range of remuneration issues, Towers Perrin and Hay Group on salary data and Monks Partnership on long-term incentive plan comparative group performance. All the independent consultants were appointed by the Company. Watson Wyatt also act as one of the retirement benefit consultants to the Company.

Nominations Committee

The Nominations Committee, chaired by Dudley Eustace, consists of Christopher O'Donnell and Dr. Rolf Stomberg. It oversees plans for Board of Directors succession and recommends appointments to the Board of Directors.

Disclosures Committee

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The Disclosures Committee, chaired by Christopher O Donnell, consists of Peter Hooley, Finance Director, and Angie Craig, Director of Corporate Affairs. It approves the releases of all communications to investors and to the London and New York Stock Exchanges.

Full details of the terms of reference of the Audit, Remuneration, Nominations and Disclosures Committees may be found at www.smith-nephew.com.

EMPLOYEES

Smith & Nephew had an average of 7,506 full-time equivalent employees in 2002, of whom 1,740 were located in the United Kingdom, 3,090 were located in the United States and 2,676 were located in other countries. The Group does not employ a significant number of temporary employees.

The average number of employees for the past three years broken down by activity and geographic location was:

	Years ended December 31		
	2002	2001	2000
	(Number)		
Orthopaedics	2,649	2,494	2,392
Endoscopy	1,677	1,449	1,419
Advanced wound management	2,951	2,621	2,479
Ongoing operations	7,277	6,564	6,290
Operations contributed to the joint venture		846	2,500
Continuing operations	7,277	7,410	8,790
Discontinued operations	229	516	1,645
	7,506	7,926	10,435

	Years ended December 31		
	2002	2001	2000
	(Number)		
United Kingdom	1,740	1,810	2,589
Continental Europe	1,279	1,281	1,549
United States	3,090	3,057	2,974
Other America	201	253	413
Africa, Asia and Australasia	1,196	1,525	2,910
	7,506	7,926	10,435

Smith & Nephew conducts a companywide employee opinion survey every two years to track and monitor employee attitudes at all locations. Response rates are very high and the general level of employee satisfaction is good. Where the Company has collective bargaining arrangements in place with labor unions, these reflect local market circumstances. The Company believes that the relationship between its operating subsidiaries and unions is satisfactory.

SHARE OWNERSHIP

The following table sets forth certain information as of April 7 2003 concerning the ownership by the Directors of the Ordinary Shares.

	Ordinary Shares of 12 2/9p(i)
Dudley G. Eustace	49,679
Christopher J. O. Donnell	122,136
Peter Hooley	111,571
Sir Timothy Lankester	6,096
Dr. Rolf W. H. Stomberg	6,945
Warren D. Knowlton	12,501
Richard De Schutter	200,000
Brian Larcombe	
Dr. Pamela J. Kirby	

(i) Holdings of the directors together represent less than 1% of the Ordinary Share capital of the Company.

As of April 7, 2003, Executive Officers together hold a total of 366,250 Ordinary Shares, representing less than 1% of the Ordinary Share capital of the Company.

The following table sets forth certain information regarding Ordinary Shares the subject of options. Outstanding options to subscribe for such Ordinary Shares as of April 7, 2003 by share option plan were:

	Exercisable in stages between	Exercise prices per Ordinary Share range between	Ordinary Shares the subject of options
	(Dates)	(Pence)	(Number)
Smith & Nephew 1985 Share Option Scheme(i)	2003 and 2010	143.0p and 265.0p	1,029,846
Smith & Nephew 1990 International Executive Share Option Scheme(i)	2003 and 2010	143.0p and 270.0p	7,973,260
Smith & Nephew Long Term Incentive Plan(i)	2003 and 2010	n/a (iii)	973,720
Smith & Nephew 2001 UK Approved Executive Share Option Plan(i)	2003 and 2009	360.0p and 409.5p	329,214
Smith & Nephew 2001 UK Unapproved Executive Share Option Plan(i)	2003 and 2009	326.0p and 409.5p	1,765,386
Smith & Nephew 2001 US Share Plan(i)	2003 and 2009	US\$5.28 and US\$5.94	3,891,600
Smith & Nephew Employee Share Option Scheme(ii)	2003 and 2007	140.4p and 289.2p	2,239,116
Smith & Nephew 1991 Overseas Employee Share Option Plan(ii)	2003 and 2007	140.4p and 289.2p	183,853
Smith & Nephew Sharesave Plan (2002)(ii)	2005 and 2008	296.0p	905,931
Smith & Nephew International Sharesave Plan (2002)(ii)	2005 and 2008	296.0p and 304.0p	677,638
Smith & Nephew Belgian Sharesave Plan (2002)(ii)	2006	357.0p	41,944
Smith & Nephew Dutch Sharesave Plan (2002)(ii)	2005 and 2008	296.0p	57,421
Smith & Nephew French Sharesave Plan (2002)(ii)	2006 and 2007	354.1p	28,025
Smith & Nephew Italian Sharesave Plan (2002)(ii)	2005 and 2008	372.7p	28,833

(i) Together these plans are termed Executive Schemes .

- (ii) Together these plans are termed Employee Schemes .
- (iii) The right to acquire such shares is in the form of nil-cost options.

The Company operates Sharesave plans for all employees in the United Kingdom, Australia, New Zealand, South Africa, Canada, Dubai, Germany, Sweden, Spain, Portugal, Switzerland, Austria, Norway, Belgium, Italy, the Netherlands and France. Under these plans, employees are able to save up to £250 per month for between three and five years, and are given an option to acquire a set number of shares based on the amount they commit to save. The option price is set at a maximum of a 20% discount to the market price of the shares at the time the options are granted.

Employees in the United States are able to participate in the Employee Stock Purchase Plan, which gives them the opportunity to acquire shares, in the form of ADSs, at a discount of 15% (or more if the shares appreciate in value during the plan's quarterly purchase period) to the market price, through a regular savings plan.

As at April 7, 2003, the Executive Directors and Executive Officers of Smith & Nephew held options to subscribe for the following numbers of Ordinary Shares, all of which options were granted pursuant to the above option plans (including the Smith & Nephew Long Term Incentive Plan):

	Executive Schemes	Employee Schemes
Christopher J. O. Donnell	669,368	3,192
Peter Hooley	544,249	3,349
James L. Dick	163,619	5,634
Peter W. Huntley	238,984	
Ronald M. Sparks	167,500	
Dr. Alan Suggett	45,000	3,159
Paul M. Williams	190,000	4,379
James Taylor	111,600	5,835
David Illingworth	100,000	
James A. Ralston	95,000	
Paul R. Chambers	34,500	5,738

ITEM 7 MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**MAJOR SHAREHOLDERS**

As far as is known to Smith & Nephew, the Company is not directly or indirectly owned or controlled by another corporation or by any government.

As of April 7, 2003, no people are known to Smith & Nephew to have any interest (as defined in the Companies Act 1985) in 3% or more of the Ordinary Shares, other than AXA Investment Managers (4.94%, 45,955,558 Ordinary Shares), FMR Corp & Fidelity (7.09%, 65,928,785 Ordinary Shares) and Legal & General Investment Management (3.43%, 31,890,815 Ordinary Shares).

The following table shows changes over the last three years in the percentage of the issued share capital for the Company held by major shareholders, as notified to the Company under the Companies Act 1985:

	As at December 31		
	2002	2001	2000
		(%)	
AXA Investment Management	4.96	5.75	6.00
FMR Corp & Fidelity	6.79	8.10	
Sanford C Bernstein			5.52
Hermes			4.18
Scudder Threadneedle Investments Ltd			3.18

RELATED PARTY TRANSACTIONS

None of the Directors or Officers (or any relative or spouse of such person, or any relative of such spouse, who has the same address as the Director or Officer, or who is a Director or Officer of any subsidiary of Smith & Nephew) has a material interest in any contract to which the Company or any of its subsidiaries are or were a party from the beginning of fiscal year 2000 to April 7, 2003.

HOST COUNTRY SHAREHOLDERS

Details of the portion of each class of securities held in the host country (the United States) and the number of record holders in the host country are given in Item 9 The Offer and Listing .

ITEM 8 FINANCIAL INFORMATION

CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

Financial Statements

See Item 18 Financial Statements .

Legal Proceedings

Group companies are parties to various legal proceedings, which are considered to constitute ordinary and routine litigation incidental to the business conducted by the relevant subsidiary, in some of which claims for damages in substantial amounts have been asserted. The outcome of such proceedings cannot readily be foreseen, but management believes that they will not result in any material adverse effect on the financial position of the Group.

Dividends

In 2000, management changed its dividend policy as part of its strategic emphasis on making Smith & Nephew a recognized growth business. It is the Board's intention that shareholders' future returns will come increasingly from growth in the value of their shares and so will depend less on the dividend. The Board accordingly raised the dividend cover (the ratio of profit to dividends) to around 2.5 times in respect of ordinary dividends for 2000. In 2001, this was raised to 2.7 times and in 2002 this was 3.3 times. Management believes that this dividend will leave more cash in the business for future investment in acquisitions and organic growth, to support further improvement in shareholder value. For more information see Item 3 Key Information Selected Financial Data Dividends .

SIGNIFICANT CHANGES

Other than the events discussed in Item 5 Operating and Financial Review and Prospects Trend Information , there have been no significant changes since December 31, 2002.

ITEM 9 THE OFFER AND LISTING

The principal trading market for the Ordinary Shares is the London Stock Exchange. The Ordinary Shares were listed on the New York Stock Exchange on November 16, 1999, trading in the form of ADSs evidenced by ADRs. Each ADS represents ten Ordinary Shares. The Company has a sponsored ADR facility with the Bank of New York as Depositary.

As of April 7, 2003, 1,611,874 ADSs equivalent to 16,118,740 Ordinary Shares or approximately 1.73% of the total Ordinary Shares in issue, were outstanding and were held by 20 registered holders.

As of April 7, 2003, to the knowledge of the Company, there were 27,472 registered holders of Ordinary Shares, of whom 86 had registered addresses in the United States and held a total of 350,664 Ordinary Shares (0.04% of the total issued). Because certain Ordinary Shares are registered in the names of nominees, the number of shareholders with registered addresses in the United States is not representative of the number of beneficial owners of Ordinary Shares resident in the United States.

The following table sets forth for the periods indicated the highest and lowest middle market quotations for the Ordinary Shares, as derived from the Daily Official List of the UK Listing Authority and the highest and lowest sales prices of ADSs as reported on the New York Stock Exchange composite tape.

Fiscal Year ended December 31:

	Ordinary Shares		ADSs	
	High	Low	High	Low
	£	£	US\$	US\$
1998	1.87	1.32		
1999	2.18	1.50	34.63	32.88
2000	3.30(i)	1.57	46.13	25.13
2001	4.20	2.91	60.91	41.80
2002	4.30	3.05	64.60	47.00

Quarters in the Fiscal Year ended December 31:

	Ordinary Shares		ADSs	
	High	Low	High	Low
	£	£	US\$	US\$
2001:				
1 st Quarter	3.33	2.91	48.50	41.80

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2 nd Quarter	3.69	3.15	45.00	52.90
3 rd Quarter	3.72	3.08	53.65	44.40
4 th Quarter	4.20	3.39	60.91	48.25
2002:				
1 st Quarter	4.30	3.84	62.40	55.12
2 nd Quarter	4.12	3.36	60.10	50.85
3 rd Quarter	3.85	3.05	60.78	47.00
4 th Quarter	4.05	3.52	64.60	56.40
2003:				
1 st Quarter	4.00	3.32	63.09	52.90

End of the Month:

	Ordinary Shares		ADSs	
	High	Low	High	Low
	£	£	US\$	US\$
October 2002	4.05	3.70	64.60	58.70
November 2002	3.86	3.52	61.30	56.40
December 2002	3.98	3.66	63.50	58.15
January 2003	3.88	3.32	62.40	52.90
February 2003	3.55	3.38	58.24	55.18
March 2003	4.00	3.41	63.09	54.25
April 2003 (through April 7, 2003)	4.15	3.95	64.49	62.31

(i) This does not include the anomalous closing share price of 386p on July 31, 2000 on the London Stock Exchange.

ITEM 10 ADDITIONAL INFORMATION

MEMORANDUM AND ARTICLES OF ASSOCIATION

The following summarizes certain material rights of holders of the Company's ordinary shares under the material provisions of the Company's memorandum and articles of association and English law. This summary is qualified in its entirety by reference to the Companies Act 1985 of Great Britain (the "Companies Act") and the Company's memorandum and articles of association. Copies of the Company's memorandum and articles of association have been filed as exhibits to this Annual Report on Form 20-F. The 5½% cumulative preference shares have no voting rights but convey preferential rights to dividends and distribution on winding up.

The Company's shares may be held in certificated or uncertificated form. No holder of the Company's shares will be required to make additional contributions of capital in respect of the Company's shares in the future.

In the following description, a "shareholder" is the person registered in the Company's register of members as the holder of an ordinary share.

The Company is incorporated under the name "Smith & Nephew plc" and is registered in England and Wales with registered number 324357. The fourth clause of the Company's memorandum of association provides that its objects include to carry on business as an investment holding company, to carry on all or any of the businesses of dealers in and manufacturers of surgical dressings and instruments, pharmaceutical preparations or articles, proprietary articles of all kinds, surgical and scientific apparatus and materials of all kinds and buyers and sellers of goods of all kinds. The memorandum grants to the Company a range of corporate capabilities to effect these objects.

Directors

Under the Company's articles of association, a Director may not vote in respect of any contract, arrangement, transaction or proposal in which he, or any person connected with him, has any material interest other than by virtue of his interests in securities of, or otherwise in or through, the Company. This is subject to certain exceptions relating to proposals (a) indemnifying him in respect of obligations incurred on behalf of the Company, (b) indemnifying a third party in respect of obligations of the Company for which the Director has assumed responsibility under an indemnity or guarantee, (c) relating to an offer of securities in which he will be interested as an underwriter, (d) concerning another body corporate in which the Director is beneficially interested in less than one percent of the issued shares of any class of shares of such a body corporate, (e) relating to an employee benefit in which the director will share equally with other employees and (f) relating to any insurance that the Company is empowered to purchase for the benefit of Directors of the Company in respect of actions undertaken as Directors (or officers) of the Company.

A Director shall not vote or be counted in any quorum concerning his own appointment or terms of his appointment.

The Directors are empowered to exercise all the powers of the Company to borrow money, subject to the limitation that the aggregate amount of all monies borrowed after deducting cash and current asset investments by the Company and its subsidiaries shall not exceed an amount equal to two and one half times the Company's consolidated share capital and aggregate reserves, but after: adjustments for the variation to share capital

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and aggregate reserves since the latest audited consolidated balance sheet; and deducting distributed and proposed distributions not previously provided out of profits earned prior to the date of the latest audited consolidated balance sheet, any amount attributable to non-Group shareholders in subsidiaries of the Company and any debit balance on the combined or Group profit and loss account, unless sanctioned by an ordinary resolution of the Company.

Any Director who has been appointed by the Directors since the previous Annual General Meeting of shareholders, either to fill a casual vacancy or as an additional Director, holds office only until the next Annual General Meeting and then shall be eligible for election by the shareholders. The other Directors shall retire and be eligible for re-appointment at the third annual general meeting after the meeting at which they were last re-appointed. The Directors are subject to removal with or without cause by the Board or the Shareholders. Any director attaining 70 years of age shall retire at the next Annual General Meeting. Such a Director may be re-appointed but shall retire (and be eligible for reappointment) at the next Annual General Meeting.

Directors are not required to hold any shares of the Company by way of qualification.

Rights Attaching to Shares

Under English law, dividends are payable on the Company's ordinary shares only out of profits available for distribution, as determined in accordance with accounting principles generally accepted in the United Kingdom and by the Companies Act. Holders of the Company's ordinary shares are entitled to receive such dividends as may be declared by the shareholders in general meeting, rateable according to the amounts paid up on such shares, provided that the dividend cannot exceed the amount recommended by the Directors.

The Company's Board of Directors may pay shareholders such interim dividends as appear to them to be justified by the Company's financial position. If authorized by an ordinary resolution of the shareholders, the Board may also direct payment of a dividend in whole or in part by the distribution of specific assets (and in particular of paid up shares or debentures of the Company).

Any dividend unclaimed after 12 years from the date the dividend was declared, or became due for payment, will be forfeited and will revert to the Company.

Voting Rights

Voting at any general meeting of shareholders is by a show of hands unless a poll, which is a written vote, is duly demanded. On a show of hands, every shareholder who is present in person or by proxy at a general meeting has one vote regardless of the number of shares held. On a poll, every shareholder who is present in person or by proxy has one vote for every $12\frac{2}{9}$ pence in nominal amount of the shares held by that shareholder. A poll may be demanded by any of the following:

the chairman of the meeting;

at least five shareholders entitled to vote at the meeting;

any shareholder or shareholders representing in the aggregate not less than one-tenth of the total voting rights of all shareholders entitled to vote at the meeting; or

any shareholder or shareholders holding shares conferring a right to vote at the meeting on which there have been paid-up sums in aggregate equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

A proxy form will be treated as giving the proxy the authority to demand a poll, or to join others in demanding one.

The necessary quorum for a general meeting is two shareholders present in person carrying a right to vote upon the business to be transacted.

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Matters are transacted at general meetings of the Company by the processing and passing of resolutions of which there are three kinds:

an ordinary resolution, which includes resolutions for the election of Directors, the approval of financial statements, the cumulative annual payment of dividends, the appointment of auditors, the increase of authorized share capital or the grant of authority to allot shares;

a special resolution, which includes resolutions amending the Company's memorandum and articles of association, disapplying statutory pre-emption rights or changing the Company's name; and

an extraordinary resolution, which includes resolutions modifying the rights of any class of the Company's shares at a meeting of the holders of such class or relating to certain matters concerning the Company's winding up.

An ordinary resolution requires the affirmative vote of a majority of the votes of those persons voting at a meeting at which there is a quorum.

Special and extraordinary resolutions require the affirmative vote of not less than three-fourths of the persons voting at a meeting at which there is a quorum.

In the case of an equality of votes, whether on a show of hands or on a poll, the chairman of the meeting is entitled to cast the deciding vote in addition to any other vote he may have.

Annual General Meetings must be convened upon advance written notice of 21 days. Other meetings must be convened upon advance written notice of 21 days for the passing of a special resolution and 14 days for any other resolution, depending on the nature of the business to be transacted. The days of delivery or receipt of notice are not included. The notice must specify the nature of the business to be transacted. Meetings are convened by the Board of Directors. Members with 10% of the Ordinary Share capital of the Company may requisition the Board to convene a meeting.

Variation of Rights

If, at any time, the Company's share capital is divided into different classes of shares, the rights attached to any class may be varied, subject to the provisions of the Companies Act, with the consent in writing of holders of three-fourths in value of the shares of that class or upon the adoption of an extraordinary resolution passed at a separate meeting of the holders of the shares of that class. At every such separate meeting, all of the provisions of the articles of association relating to proceedings at an Extraordinary General Meeting apply, except that the quorum is to be the number of persons (which must be two or more) who hold or represent by proxy not less than one-third in nominal value of the issued shares of the class and at any such meeting a poll may be demanded in writing by any five persons who hold or represent by proxy not less than one fortieth of the nominal value of the shares of that class.

Rights in a Winding-up

Except as the Company's shareholders have agreed or may otherwise agree, upon the Company's winding up, the balance of assets available for distribution:

after the payment of all creditors including certain preferential creditors, whether statutorily preferred creditors or normal creditors;
and

subject to any special rights attaching to any other class of shares;

is to be distributed among the holders of ordinary shares according to the amounts paid-up on the shares held by them. This distribution is generally to be made in cash. A liquidator may, however, upon the adoption of any extraordinary resolution of the shareholders and any other sanction required by law, divide among the shareholders the whole or any part of the Company's assets in kind.

Limitations on Voting and Shareholding

There are no limitations imposed by English law or the Company's memorandum or articles of association on the right of non-residents or foreign persons to hold or vote the Company's ordinary shares or ADSs, other than the limitations that would generally apply to all of the

Company's shareholders.

MATERIAL CONTRACTS

As detailed in Item 4 Information on the Company History and Development of the Company Recent Developments, Smith & Nephew acquired ORATEC Interventions, Inc. in March 2002 pursuant to a merger agreement (see exhibits to this Form 20-F).

As described above under Item 4 Information on the Company History and Development of the Company Recent Developments, the Company and Smith & Nephew Group entered into the Combination Agreement and the InCentive Agreement in connection with the planned acquisition of all the outstanding shares of Centerpulse. As described above under Item 5 Operating and Financial Review and Prospects-Liquidity, the Company and Smith & Nephew Group also entered into the Credit Agreement. Copies of the Combination Agreement, the InCentive Agreement and the Credit Agreement are filed as exhibits to this Form 20-F.

EXCHANGE CONTROLS

There are no UK governmental laws, decrees or regulations that restrict the export or import of capital or that affect the payment of dividends, interest or other payments to non-resident holders of Smith & Nephew's securities, except for certain restrictions imposed from time to time by Her Majesty's Treasury of the United Kingdom pursuant to legislation, such as the United Nations Act 1946 and the Emergency Laws Act 1964, against the government or residents of certain countries.

There are no limitations, either under the laws of the United Kingdom or under the Articles of Association of Smith & Nephew, restricting the right of non-UK residents to hold or to exercise voting rights in respect of Ordinary Shares, except that where any overseas shareholder has not provided to the Company a UK address for the service of notices, the Company is under no obligation to send any notice or other document to an overseas address. It is, however, the current practice of the Company to send every notice or other document to all shareholders regardless of the country recorded in the register of members, with the exception of details of the Company's dividend re-investment plan, which are not sent to shareholders with recorded addresses in Canada.

TAXATION

The comments below are of a general and summary nature and are based on the Company's understanding of certain aspects of current UK and US federal law and practice relevant to the ADSs and Ordinary Shares not in ADS form. The comments address certain US and UK tax consequences to a person who is the beneficial owner of ADSs or Ordinary Shares and who, for US federal income tax purposes, is a US citizen or resident, a corporation or partnership created or organized in or under the laws of the United States, or an estate or trust treated as a United States person under Section 7701(a)(30) of the US Internal Revenue Code (a "US Holder"). The comments set out below do not purport to address all material tax consequences of the ownership of ADSs or Ordinary Shares and in particular do not deal with the position of shareholders who directly or indirectly own 10% or more of the issued Ordinary Shares. Special rules apply to persons operating clearance and/or depository services and those whose holding of ADSs or Ordinary Shares is effectively connected with or pertains to either (i) a permanent establishment in the United Kingdom through which the US Holder carries on a business in the United Kingdom, or (ii) a fixed base from which the US Holder performs independent personal services in the United Kingdom. Special rules also apply to certain investors such as tax-exempt entities, insurance companies, broker-dealers, traders in securities that elect to mark to market, US Holders holding ADSs or Ordinary Shares as part of a hedging or conversion transaction or whose functional currency is other than the US dollar and investors liable for alternative minimum tax. In addition, the comments below do not relate to state, local or non-US (other than UK) taxes. The summary deals only with US Holders who hold ADSs or Ordinary Shares as capital assets. The summary is based on the Company's understanding of current US and UK law and practice and advice received from the Company's UK and US tax advisors. US Holders are recommended to consult their own tax advisors as to the particular consequences to them of the ownership of ADSs or Ordinary Shares.

For the purpose of the US/UK Double Taxation Treaty and US domestic tax law US Holders of ADSs will be treated as beneficial holders of the Ordinary Shares represented by the ADSs.

Taxation Of Dividends In The United Kingdom

Smith & Nephew is not obliged to pay UK advance corporation tax (ACT) on dividends paid on or after April 6, 1999. An individual UK shareholder is treated as receiving taxable income equal to the dividend plus a tax credit of one-ninth of the cash dividend received. This tax credit may be set against the individual's overall UK income tax liability, but in general the tax credit will not be repaid. Under the provisions of the US/UK Double Taxation Treaty, while a UK individual is entitled to a tax credit in respect of dividends paid by a UK company, a US Holder

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will be entitled to a repayment from the UK Inland Revenue of the tax credit less an amount not exceeding 15% of the aggregate of the cash dividend and the tax credit. As 15% of the aggregate of the cash dividend and the tax credit would exceed the tax credit due, no repayment of the tax credit will be available from the UK Inland Revenue for dividends paid on or after April 6, 1999.

Taxation Of Dividends In The United States

Dividends will be treated as ordinary income to a US Holder when the dividend is received to the extent paid out of earnings and profits as determined for US federal income tax purposes. Dividends will not be eligible for the dividends-received deduction generally allowed to US corporations in respect of dividends received from other US corporations. The amount of the dividend included in taxable income is the US dollar value of the dividend, converted using the exchange rate on the date of receipt. Distributions in excess of earnings and profits, as determined for US federal income tax purposes, are generally treated as a return of capital (and a reduction of tax

basis for US federal income tax purposes) to the extent of the US Holder's investment in the ADSs and Ordinary Shares and thereafter realized as a capital gain. Conversion by a US Holder of sterling received as a distribution from Smith & Nephew into US dollars may result in ordinary income to the US Holder to the extent attributable to fluctuations in foreign currency exchange rates between the date of receipt and the date of conversion.

A US Holder may elect to be treated as receiving the UK tax credit in respect of dividends paid by a UK company without affirmatively making a claim to the United Kingdom by so indicating on Line 5 of Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) and filing the completed Form 8833 with the US Holder's income tax return for the relevant year. A US Holder making this election will be treated as having received an additional dividend equal to the gross amount of the tax credit (unreduced by amounts withheld), and as having paid the withholding tax due. Thus, the investor must include in income the gross payment deemed received, and may claim a foreign tax credit for the withholding tax treated as paid to the United Kingdom (which tax will be considered due and paid only to the extent of the tax credit).

For US foreign tax credit limitation purposes, dividends generally will be passive income from sources outside the United States. Any exchange gain or loss arising from sterling receipts in respect of dividends paid by Smith & Nephew will generally be treated as ordinary income or loss which is US source income for foreign tax credit limitation purposes.

Taxation of Capital Gains

US Holders, who are not resident or ordinarily resident for tax purposes in the United Kingdom, will not generally be liable for UK capital gains tax on any capital gain realized upon the sale or other disposition of ADSs and Ordinary Shares unless held in connection with a trade carried on in the United Kingdom through a branch or agency. Furthermore, UK resident individuals who acquire ADSs or Ordinary Shares before becoming temporarily non-UK resident, may remain subject to UK taxation of capital gains on gains realized while non-resident.

For US tax purposes, gains realized upon the sale or disposition of ADSs and Ordinary Shares by US Holders generally will be capital gains and will be long-term capital gains if the ADSs or Ordinary Shares were held for more than one year. For non-corporate US Holders, net long-term capital gain is subject to a maximum rate of 20%. Gains realized on sale generally will not be regarded as foreign source income for federal income tax purposes.

Inheritance and Estate Taxes

The UK Inland Revenue imposes inheritance tax on capital transfers which occur on death, and in the seven years preceding death. The UK Inland Revenue considers that the US/UK Double Taxation Convention on Estate and Gift Tax applies to inheritance tax. Consequently, a US citizen who is domiciled in the United States and is not a UK national or domiciled in the United Kingdom will not be subject to UK inheritance tax in respect of ADSs and Ordinary Shares. A UK national who is domiciled in the United States will be subject to both UK inheritance tax and US Federal Estate Tax but will be entitled to a credit for US Federal Estate Tax charged in respect of ADSs and Ordinary Shares in computing the liability to UK inheritance tax. Conversely, a US citizen who is domiciled or deemed domiciled in the United Kingdom will be entitled to a credit for UK inheritance tax charged in respect of ADSs and Ordinary Shares in computing the liability to US Federal Estate Tax. Special rules apply where ADSs and Ordinary Shares are business property of a permanent establishment of an enterprise situated in the United Kingdom.

US Backup Withholding Tax

A US Holder may be subject to US backup withholding tax at the rate of 30% (which rate is scheduled to be reduced periodically through 2006) on dividends paid within the United States in respect of ADSs and Ordinary Shares or on the payment of the proceeds from the sale of ADSs or Ordinary Shares, unless the shareholder is a corporation or other exempt recipient, or provides a US taxpayer identification number. US backup withholding tax may also apply if there has been a notification from the Internal Revenue Service of a failure to report all interest or dividends. US information reporting and backup withholding generally will not apply to a payment made outside the United States through an office outside the United States of a non-US broker.

Backup withholding tax deducted may be credited against the US Holder's US income tax liability, and, where the withholding tax exceeds the actual liability, the US Holder may obtain a refund by filing the appropriate refund claim with the Internal Revenue Service.

UK Stamp Duty and Stamp Duty Reserve Tax

UK stamp duty is charged on documents and in particular instruments for the transfer of registered ownership of Ordinary Shares. Transfers of Ordinary Shares will generally be subject to UK stamp duty at the rate of ½% of the consideration given for the transfer with the duty rounded up to the nearest £5 if necessary.

UK stamp duty reserve tax (SDRT) arises when there is an agreement to transfer shares in UK companies for consideration in money or money's worth, and so an agreement to transfer Ordinary Shares for money or other consideration may give rise to a charge to SDRT at the rate of ½% (rounded up to the nearest penny). If an instrument of transfer of the Ordinary Shares is subsequently executed the instrument of transfer will generally be subject to stamp duty. The charge of SDRT will be cancelled, and any SDRT already paid will be refunded, if within 6 years of the agreement an instrument of transfer is produced to the United Kingdom Inland Revenue and the appropriate stamp duty paid.

Transfers of Ordinary Shares into CREST (an electronic transfer system) are exempt from stamp duty so long as the transferee is a member of CREST who will hold the Ordinary Shares as a nominee for the transferor and the transfer is in a form that will ensure that the securities become held in uncertificated form within CREST. Paperless transfers of Ordinary Shares within CREST for consideration in money or money's worth are liable to SDRT rather than stamp duty. SDRT on relevant transactions will be collected by CREST at ½%, and this will apply whether or not the transfer is effected in the United Kingdom and whether or not the parties to it are resident or situated in the United Kingdom.

A charge of stamp duty or SDRT at the rates of 1½% of the consideration (or, in some circumstances, the value of the shares concerned) will arise on a transfer or issue of Ordinary Shares to the Depository or to certain persons providing a clearance service (or their nominees or agents) and will generally be payable by the Depository or person providing clearance service. In accordance with the terms of the Deposit Agreement, any tax or duty payable by the Depository on deposits of Ordinary Shares will be charged by the Depository to the party to whom ADRs are delivered against such deposits. No liability for SDRT will arise on any agreement to transfer an ADS or beneficial interest in an ADS.

No liability for stamp duty will arise on any transfer of, or agreement to transfer, an ADS or beneficial ownership of an ADS, provided that the ADS and any instrument of transfer or written agreement to transfer remains at all times outside the United Kingdom, and provided further that any instrument of transfer or written agreement to transfer is not executed in the United Kingdom and the transfer does not relate to any matter or thing done or to be done in the United Kingdom (the location of the custodian as a holder of Ordinary Shares not being relevant in this context). In any other case, any transfer of, or agreement to transfer, an ADS or beneficial ownership of an ADS could, depending on all the circumstances of the transfer, give rise to a charge to stamp duty.

US/UK Double Taxation Treaty

On March 31, 2003, the United States and the United Kingdom ratified a new income tax treaty to replace the currently effective US/UK Double Taxation Treaty. Among other things, the new income tax treaty eliminates the tax credit available to US Holders described above under "Taxation of Dividends in the United Kingdom" and "Taxation of Dividends in the United States". The new income tax treaty generally becomes effective with respect to withholding taxes on May 1, 2003, UK corporation tax on April 1, 2003, UK income and capital gains tax on April 6, 2003, UK corporation tax on April 1, 2003, UK income and capital gains tax on April 6, 2003 and US income tax on January 1, 2004. Taxpayers may elect to have the old treaty apply for a twelve-month period from which the new treaty would otherwise apply. In addition, the US/UK Double Taxation Convention on Estate and Gift Tax is currently subject to re-negotiation.

DOCUMENTS ON DISPLAY

It is possible to read and copy documents referred to in this Annual Report on Form 20-F that have been filed with the SEC at the SEC's public reference room located at 450 Fifth Street, NW, Washington DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. The SEC also maintains a web site at <http://www.sec.gov> that contains reports and other information regarding registrants that file electronically with the SEC. This Form 20-F report and some of the other information submitted by the Company to the SEC may be accessed through this website.

ITEM 11 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Qualitative information on treasury management and exchange rate and interest rate risk is disclosed in Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources .

Quantitative Information About Market Risk

The market value of the Group's financial instruments is affected by movements in both interest rates and exchange rates. The sensitivity of profits and cash flows to selective movements in interest rates and exchange rates are discussed below. The sensitivity analysis is based on a range of movements in market rates which could be reasonably expected over the period of a year.

Interest rate sensitivity

The majority of the Group's financial assets and liabilities, including currency swaps, are at floating interest rates. The Group uses simple floating to fixed rate contract interest rate swaps to meet its objective of protecting borrowing costs and differentials between borrowing and deposit rates within parameters set by the Board. 75% of the interest costs and 83% of the interest income are protected through December 2003, with some protection carrying over into 2004. The following table sets forth notional amounts and weighted average interest rates by expected maturity dates. Variable rates are based on rates at December 31, 2002. The information is presented in sterling and the actual currency of the interest rate swaps is indicated in parentheses.

	Expected to mature in years ending December 31		Fair value(i) (£ million)
	2003	2004	
	(£ million, except interest rates)		
At December 31, 2002:			
Principal (sterling)	503	103	6.5
Fixed rate receivable	5.1%	4.8%	
Variable rate payable	3.9%	4.2%	
Principal (US dollars)	563	112	(14.2)
Fixed rate payable	3.8%	3.0%	
Variable rate receivable	1.4%	2.4%	
Principal (euros)	100	26	(1.1)
Fixed rate payable	3.4%	4.5%	
Variable rate receivable	2.7%	3.0%	

- (i) The fair values for interest rate swaps are calculated as the net present value of the future cash flows as at December 31, 2002, discounted at market rates of interest at that date.

Expected to mature in years
ending

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	December 31			Fair value(ii)
	2002	2003	2004	
	(£ million, except interest rates)			
At December 31, 2001:				
Principal (sterling)	396	140	25	4.0
Fixed rate receivable	5.5%	5.5%	5.6%	
Variable rate payable	4.4%	4.4%	4.4%	
Principal (US dollars)	483	113		(10.2)
Fixed rate payable	4.6%	4.4%		
Variable rate receivable	2.4%	2.4%		
Principal (euros)	103	60	25	(0.5)
Fixed rate payable	4.1%	3.6%	4.5%	
Variable rate receivable	3.3%	3.3%	3.3%	

(ii) The fair values for interest rate swaps are calculated as the net present value of the future cash flows as at December 31, 2001, discounted at market rates of interest at that date.

In 2002, an increase of one percentage point in sterling and US dollar interest rates would have reduced the fair value of sterling interest rate swaps by £6 million and increased the fair value of US dollar interest rate swaps by £7 million. In the case of decreases in interest rates of one percentage point, the changes to the fair values of the interest rate swaps would have been an increase of £6 million relating to sterling and a reduction of £7 million relating to US dollars.

Exchange rate sensitivity

All financial instruments denominated in currencies other than sterling hedge foreign currency assets. As a result, changes in fair values of financial instruments do not affect the Group's profit before taxation. The value of foreign currency financial liabilities is expected to be matched by foreign currency cash flows arising from the hedged assets in the longer term. Currency swaps are at floating rates of interest. Foreign currency liabilities outstanding at December 31, 2002 are listed by maturity and currency as follows:

Amount receivable
